BANKRUPTCIES AND BAILOUTS: THE CONTINUING IMPACT OF THE FINANCIAL CRISIS ON THE FRANCHISE AUTO DEALER INDUSTRY

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ABSTRACT

An intricately intertwined network of corporate manufacturers, independently-owned dealers, suppliers, and workers, the U.S. auto industry has been a staple of the American economy for the better part of the last century. However, in the wake of globalization, ever-increasing foreign competition, and the Financial Crisis, only governmental intervention has allowed the U.S. auto industry to remain viable over the last decade. But did the governmental intervention achieve its intended purpose? And, in the long run, is governmental intervention the only answer to shield a fledgling U.S. auto industry from the ebbs and flows of a global economy? Perhaps the source of the U.S. auto industry’s viability issues does not lie within the macro-level circumstances that surround it—but, rather, in the franchise business model it utilizes.

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INTRODUCTION

For a century, the U.S. auto industry has relied on a traditional business model of selling cars through local dealerships. This business model has usually worked well. However, the latest financial crisis and worst recession since the Great Depression (hereinafter, the “Financial Crisis”) necessitated governmental intervention to resuscitate the industry.\(^1\) Revived U.S.
automakers now face a quandary: either continue the relatively comfortable, century-old business model that nearly led, save governmental action, to the demise of the U.S. auto industry, or seek alternatives to producing cars and selling those cars through local dealerships. The Financial Crisis taught Chrysler, General Motors, and Ford—Detroit’s “Big Three” automakers—lessons leading to profound changes in how each company does business. In this article, we ask: did the bailout of 2009 actually work, and—more importantly—is it time for the U.S. auto industry to do away with its business model of using local dealerships (independently-owned franchises) to sell its vehicles? If not, or if so, is this business model the very reason why the U.S. auto industry will inevitably, as we have seen more than once in the past, need a bailout? We answer these questions in the affirmative, examine the Financial Crisis and its impact on the U.S. auto industry both during and after, and suggest that a change to current state laws prohibiting direct sales from auto manufacturers to consumers could lead to greater long-term financial stability for the U.S. auto industry.

I. THE FINANCIAL CRISIS

We first turn to the Financial Crisis on a macro-level and analyze the events that led to one of the deepest recessions in U.S. history. We then examine the impact of the Financial Crisis on the U.S. auto industry in particular, and why each of the Big Three automakers were hit the hardest, necessitating, in one form or another, a governmental bailout of each.

A. The Financial Crisis and the U.S. Economy: A Parade of Horribles

In July 2007, the collapse of two Bear Stearns hedge funds, capitalized at $1.6 billion, marked the beginning of what some commentators have called the Great Recession (more popularly known as the Financial Crisis). The collapse of Bear Stearns and its eventual government-brokered and guaranteed forced sale to J.P. Morgan Chase in March 2008 would only be the beginning of a series of events and decisions that tanked the U.S.
In September 2008, the U.S. government was forced to put two mortgage giants, Fannie Mae and Freddie Mac, under “conservatorship” when the two companies saw $12 billion in losses since the summer of 2007 and both companies, combined, guaranteed about $5.4 trillion in home loans—about half the mortgage debt of the entire United States. Soon after, Lehman Brothers Holdings Inc. (“Lehman Brothers”), the fourth largest U.S. investment bank, would add itself to the ranks of failed financial institutions.

3. Id. at 43. During this forced sale, JP Morgan Chase initially agreed to pay $2 per share to buy all of Bear Stearns’ stock, with $30 billion of Bear Stearns’ most toxic assets guaranteed by the federal government. See Andrew Ross Sorkin, JP Morgan Pays $2 a Share for Bear Stearns, N.Y. TIMES (Mar. 17, 2008), http://www.nytimes.com/2008/03/17/business/17bear.html?pagewanted=all [https://perma.cc/2YL2-JS55] (outlining JP Morgan’s initial offer to buyout Bear Stearns). A week later, JP Morgan Chase revised its initial bid and agreed to pay $10 per share for Bear Stearns’ stock in an attempt to pacify both Wall Street and discontent Bear Stearns’ shareholders, with the federal government guaranteeing only $29 billion of Bear Stearns’ assets on a nonrecourse basis. See Andrew Ross Sorkin, JP Morgan Raises Bid for Bear Stearns to $10 a Share, N.Y. TIMES (Mar. 24, 2008), http://www.nytimes.com/2008/03/24/business/24deal-web.html?pagewanted=all&_r=0 [https://perma.cc/S5W6-R6NU] (detailing JP Morgan’s revised bid to buy out Bear Stearns). A year prior to the forced sale, the company’s stock was selling for $170 a share.

4. See David Ellis, U.S. Seizes Fannie and Freddie, CNN MONEY (Sept. 7, 2008), http://money.cnn.com/2008/09/07/news/companies/fannie_freddie/ [https://perma.cc/3VGL-UUNN] (discussing the U.S. government’s acquisitions of Fannie Mae and Freddie Mac during the Financial Crisis). The move, which extended about $200 billion in treasury funds to the two companies, marked a dramatic attempt by the U.S. government to gain some control over the crumbling housing and financial markets. Id. According to Henry Paulson, former U.S. Treasury Secretary, “[a] failure [of Fannie Mae and Freddie Mac] would affect the ability of Americans to get home loans, auto loans, and other consumer credit and business finance . . . and a failure would be harmful to economic growth and job creation.” Id. Under the conservatorship, the Federal Housing Finance Agency (“FHFA”) would take control of the boards of both companies and the CEOs of each company would be replaced by individuals appointed by the FHFA. Id. The U.S. Treasury would also buy mortgage-backed securities from Fannie Mae and Freddie Mac and buy the preferred stock of the two companies to provide security to the debt holders of the two companies and bolster additional housing finance. Id. At the time, U.S. government sources said the conservatorship amounted to “a timeout, not a liquidation . . . leave[ing] all options open for the next administration.” Id. However, as of February 2018, the FHFA is still acting as conservator of Fannie Mae and Freddie Mac because, according to the FHFA, each company lacks capital, cannot rebuild its capital base, and “is operating on a remaining, finite financial commitment from taxpayers.” FHFA As Conservator of Fannie Mae and Freddie Mac, FEDERAL HOUSING FINANCE AGENCY, http://www.fhfa.gov/Conservatorship/Pages/History-of-Fannie-Mae--Freddie-Conservatorships.aspx [https://perma.cc/4XCE-HFKK] (last visited Nov. 26, 2018); see also GARY STRUMEYER, THE CAPITAL MARKETS: EVOLUTION OF THE FINANCIAL ECOSYSTEM 244 (2018) (discussing the overall FHFA rules and principles).

5. Page, supra note 2, at 43.
On September 14, 2008, Lehman Brothers filed for relief under Chapter 11 of the U.S. Bankruptcy Code, marking the beginning of what would be the largest bankruptcy in U.S. history, after the company was unable to find a buyer to take over the company and its toxic mortgage assets or to procure financial assistance from the U.S. government. That same day, Bank of America agreed to buy Merrill Lynch for $50 billion, or $29 a share, when the 94-year-old company saw $39 billion in losses and write-downs primarily from mortgage-contaminated securities. On September 16, 2008, in the wake of the Lehman Brothers bankruptcy, the U.S. government decided to bail out American International Group Inc. (“AIG”), one of the world’s largest insurance companies, in an $85 billion deal to prevent the potential collapse of the U.S. financial system. In the weeks that followed, the prospects of other financial institutions also began to wane. On September 26, 2008, the U.S. government seized Washington Mutual, a former Seattle-based national retail bank that desperately needed cash after a wave of consumer deposit withdrawals. The U.S. government then sold

6. See 11 U.S.C. §§ 1101-1174 (2014) (allowing debtors who are not insolvent, in that their liabilities do not exceed their assets, to seek relief from a bankruptcy court and obtain confirmation from the court of a reorganization plan to provide for discharge of their debts with creditors).

7. Page, supra note 2, at 42-43; see also Andrew Ross Sorkin, Lehman Files for Bankruptcy, Merrill Is Sold, N.Y. TIMES (Sept. 14, 2008), http://www.nytimes.com/2008/09/15/business/15lehman.html?pagewanted=all [https://perma.cc/F7U2-287Y] (reporting on Lehman Brothers filing for bankruptcy protection); The two most interested buyers in Lehman Brothers were Bank of America and Barclays. Id. Bank of America walked away, however, when the U.S. government refused to provide a financial backstop to potential buyers, a decision in stark contrast to the guarantees the U.S. government provided during the Bear Stearns forced sale to J.P. Morgan Chase a few months prior. Id. Similarly, after 72 hours of negotiations with U.S. officials and some opposition to the purchase from the British Government, Barclays, a British bank, also determined that it would not be in the best interests of the company or its shareholders to buy Lehman Brothers. Id; see also Andrew Ross Sorkin, What Might Have Been, and the Fall of Lehman, N.Y. TIMES (Sept. 9, 2013), http://dealbook.nytimes.com/2013/09/09/what-might-have-been-and-the-fall-of-lehman/ [https://perma.cc/J68G-BLT7] (recounting how the British government did not approve the Barclays acquisition).


Washington Mutual’s operations to J.P. Morgan Chase for $1.9 billion, marking it as the largest bank failure in U.S. history. The following month, Wells Fargo, the largest West Coast bank in the United States, agreed to acquire its rival, Wachovia, for $15.1 billion in an attempt to avoid Wachovia’s failure and another government seizure of a U.S. financial institution.

Even such a brief cataloguing of catastrophe may illustrate that the causes of the Financial Crisis are many. Some commentators believe that a credit crunch precipitated the Financial Crisis when major financial institutions refused to lend to each other. Another spark was the use of complex financial derivatives. The corresponding overinvestment, hence bubble, in real estate eventually burst due to widespread defaults in the subprime mortgage market. In the decade preceding the Financial Crisis, underwriting standards and income requirements for subprime mortgages had deteriorated. Mortgage lenders lent to households that did not have adequate income to pay back their loans. These financial institutions not only issued the subprime mortgage loans, but they also issued to investors securities backed by these subprime mortgage loans. The income stream

11. *Id.* In the deal, J.P. Morgan Chase agreed to assume Washington Mutual’s loan portfolio which contained about $307 billion in assets. *Id.*


13. See *Page*, supra note 2, at 39 (discussing the varying views of commentators concerning the cause of the Financial Crisis).


15. See *Page*, supra note 2, at 39 (discussing the domino effect caused by the bursting of the real estate bubble). Subprime mortgage loans carry an interest rate higher than the rates of prime mortgage loans. CONSUMER FIN. PROT. BUREAU, supra note 14. Mortgage lenders typically offer prime mortgage loans to borrowers with the best credit histories, which can either be fixed or adjustable rate loans. *Id.* In comparison, subprime mortgage loans are adjustable rate mortgage loans where the interest rate for the mortgage loan can significantly increase over time. *Id.* Mortgage lenders offer subprime mortgage loans to prospective borrowers with poor credit histories. *Id.* The higher interest rate for these loans is intended to compensate the mortgage lender for accepting the greater credit risk associated with lending to such borrowers. *Id.*


17. *Id.*

18. See *Page*, supra note 2, at 44 (revealing that many of the financial institutions also bought securities backed by mortgages).
for investors and the value of the mortgage-backed securities depended on the borrowers of the underlying subprime mortgage continuing to pay his or her loan. Even worse, investment banks found that they could package these mortgage-backed securities to investors via another form of complex financial derivatives called a collateral debt obligation (“CDO”). These CDOs were yet another step removed from the actual subprime mortgages themselves. The structure was a house of cards, dropped onto shifting sands. Seizing upon the AAA-ratings provided by the ratings agencies, and assuming that those highly-rated securities were low-risk, many private investors purchased these securities, which were CDOs, at face value; to make matters worse, they doubled down even more on their investments by loading their financial portfolios with such securities. Financial institutions did the same and bought these securities believing that the AAA-rating meant a good return at very low risk. Additionally, financial institutions treated the securities favorably as capital and diversified their financial portfolios with these financial instruments. Unfortunately, when widespread subprime mortgage borrowers began defaulting on their loans, the CDOs and underlying mortgage-backed securities rapidly lost value, forcing many financial institutions to write down the value of their assets and, as a result, reduce their capital. Lehman Brothers is a good example of this outcome. Investors, by comparison, simply lost their shirts.

19. Id. at 44-45.
20. Poole, supra note 16. CDOs were structured obligations with several tranches of differing risk and return composed of “pooled” mortgage assets. Id. Senior-level tranches had first priority on the mortgage interest and principal payments made by subprime mortgage borrowers while more junior-level tranches assumed higher risk and less priority on mortgage interest and principal payments by subprime mortgage borrowers but received higher returns. Id. Senior-level tranches, at the time, had a AAA-rating from rating agencies. Id. See generally Joshua D. Coval, Jakub Jurek & Erik Stafford, The Economics of Structured Finance 11-12 (Harv. Bus. Sch., Working Paper No. 09-060, 2008), available at http://www.hbs.edu/faculty/Publication%20Files/09-060.pdf [https://perma.cc/Q83Z-9JHG] (simulating the types of tranches observed in structured finance markets).
21. Page, supra note 2, at 44.
22. Page, supra note 2, at 44; Poole, supra note 16; see also Ed deHaan, The Financial Crisis and Corporate Credit Ratings, 92 ACCOUNTING REV. 161 (July 2017) (discussing the instrumentality of the rating agencies in the Financial Crisis).
23. Page, supra note 2, at 45.
24. Id. at 46.
25. Id. at 46-47.
26. Id.; see also supra notes 5-7 and accompanying text.
27. Poole, supra note 16; see also Page, supra note 2, at 45-46 (describing the reaction of investors to the collapse of Lehman Brothers).
B. The Financial Crisis and the U.S. Auto Industry

The ripple effect of the Financial Crisis was felt around the world. European banks and markets were just as affected as those in the United States.28 Similarly, Asian banks and markets also felt the pinch of the Financial Crisis.29 Around the world, output and employment fell.30 In the United States, the ripple effect of the Financial Crisis was felt across all sectors of the economy.31 In particular, for the U.S. auto industry, the Financial Crisis only exacerbated an already existing slump in competition.32

On a macro level, the Big Three automakers, General Motors, Chrysler, and Ford, had slowly been losing market share to foreign competitors for years.33 Rising fuel prices further softened demand for American cars in the United States, while the rising legacy costs of the Big Three only constrained each company’s ability to increase its competitiveness in the global market.34 These legacy costs, which are retiree costs the automobile companies pay their former employees, include healthcare for life, which amounts to an extra $16-$18 per hour on top of the hourly wages already paid.35 The problems in the financial sector that precipitated the credit crunch36 made it

29. Poole, supra note 16, at 423; see also The Origins of the Financial Crisis: Crash Course, supra note 28 (providing an overview of the impact of the Financial Crisis on Asian companies, banks and markets).
30. Poole, supra note 16, at 423.
31. Id.
34. CONGRESSIONAL REPORT, supra note 32; see also Gross, supra note 33 (explaining the challenges faced by the Big Three automakers that led to the United States offering them financial relief).
36. See infra notes 2-27 and accompanying text.
more difficult for consumers to get vehicle financing, resulting in lower consumer spending and reduced demand for American cars.\textsuperscript{37} By 2008, U.S. automotive sales had fallen to their lowest levels since 1982.\textsuperscript{38}

At the end of 2008, Congress promulgated the Emergency Economic Stabilization Act of 2008, which established the Troubled Asset Relief Program ("TARP," or more popularly known as, "the bailout").\textsuperscript{39} TARP authorized the Secretary of the Treasury to purchase troubled assets to restore confidence in the economy and stimulate the flow of credit.\textsuperscript{40} Under TARP, Congress authorized the U.S. Treasury to loan more than $700 billion in funds to aid the ailing financial industry and, according to Henry Paulson, former Secretary of the Treasury, "support financial-market stability."\textsuperscript{41} However, in December 2008, the Bush Administration, despite its previous opposition to the plan, announced that it would be lending some of the TARP funds—approximately $17.4 billion—to a dying U.S. auto industry in order to save jobs, protect the U.S. economy, and prevent the deepening of the Financial Crisis.\textsuperscript{42}

On a micro level, the failure of the U.S. auto industry necessarily starts and ends with the company practices and overall business model of the Big

\textsuperscript{37} Congressional Report, supra note 32; see also Gross, supra note 33 (talking about the various factors leading to the financial failure of the Big Three automakers).


\textsuperscript{40} \textit{See In re Chrysler LLC}, 405 B.R. 84, 89 (Bankr. S.D.N.Y. 2009) (authorizing the Secretary of Treasury to purchase troubled assets to generate confidence in the economy).


\textsuperscript{42} Id. According to President Bush, "[u]nder ordinary economic circumstances, I would say this is the price that failed companies must pay, and I would not favor intervening to prevent the auto makers from going out of business, . . . [b]ut these are not ordinary circumstances. In the midst of a financial crisis and a recession, allowing the U.S. auto industry to collapse is not a responsible course of action." \textit{Transcript: President Bush on Auto-Industry Bailout}, Fox News (Dec. 19, 2008), https://www.foxnews.com/politics/transcript-president-bush-on-auto-industry-bailout
Three.

C. The Big Three

1. Chrysler

On April 30, 2009, the U.S. Treasury Department put Chrysler into bankruptcy in an effort to restructure the company and prepare it for long-term survival.43 The filing in a Manhattan federal court marked the first time in U.S. history that a major U.S. automaker filed for bankruptcy.44 At the time of the filing, the 85-year-old company boasted 55,000 employees with an additional 140,000 workers spread throughout its sprawling network of 3,200 independent franchise dealers selling Chrysler, Dodge, and Jeep brands nationwide.45 Of the 55,000 direct employees, about 38,500 were based in the United States, with nearly 70 percent covered under a collective bargaining agreement.46 The company also paid for health care and other related benefits to over 106,000 retirees.47 Chrysler also had 32 manufacturing and assembly facilities and 24 parts depots worldwide, producing approximately 2 million vehicles under the Chrysler, Dodge, and Jeep brands annually.48 Despite such lofty numbers, in 2009, Chrysler’s sales were down, falling behind both Toyota and Honda in U.S. sales.49

At the time of the bankruptcy, Chrysler owed billions to several groups

43. Chris Isidore, Chrysler Files for Bankruptcy, CNN Money (May 1, 2009), http://money.cnn.com/2009/04/30/news COMPANIES/chrysler_bankruptcy [https://perma.cc/P2U2-Q2PS] [hereinafter “Chrysler Files for Bankruptcy”]; see also In re Chrysler LLC, 405 B.R. at 88 (discussing the reach and size of the Chrysler brand in the United States).
44. Chrysler Files for Bankruptcy, supra note 43. Chrysler had decades earlier received a loan guarantee but had not declared bankruptcy. In December 1979, Congress approved a $1.5 billion federal loan guarantee for Chrysler. JAMES M. BICKLEY, CONG. RESEARCH SERV., 7-5700, CHRYSLER CORPORATION LOAN GUARANTEE ACT OF 1979: BACKGROUND, PROVISIONS, AND COST 4 (2008). The loan was ultimately repaid, with the warrants received by the federal government, as part of the assistance, sold at auction for $311 million and—in effect—generating a profit for the government. Id.
45. Chrysler Files for Bankruptcy, supra note 43; see also In re Chrysler LLC, 405 B.R. at 88 (discussing the reach and size of the Chrysler brand in the United States).
46. In re Chrysler LLC, 405 B.R. at 88–89.
47. Id. at 90. These are the legacy costs, which tend to be a far greater proportion of labor costs for longstanding employers, particularly in strongly unionized, manufacturing firms. The need for employees has gone down due to increased productivity per employee, the use of robots, and other factors (perhaps less demand for the product), but there used to be far more employees, many now retired and collecting benefits. See supra notes 34–35 and accompanying text.
49. Chrysler Files for Bankruptcy, supra note 43.
of creditors. First, Chrysler owed close to $7 billion to a syndicate of lenders and suppliers who held a first priority security interest in substantially all of Chrysler’s assets. Second, Chrysler owed $2 billion to affiliates of its equity shareholders that held second priority in substantially all of Chrysler’s assets. Third, Chrysler owed $4.27 billion to the U.S. Treasury Department pursuant to TARP and the Canadian government, both of which held a third priority security interest in substantially all of Chrysler’s assets. Fourth, Chrysler owed $10 billion to a trust established to provide health care benefits to union retirees. This debt was unsecured. Finally, Chrysler owed approximately $5 billion in unsecured debt to various trade creditors with billions more owed in connection with various warranty and dealer obligations. Not surprisingly, in the year preceding the bankruptcy filing, the company had approximately $39.3 billion in assets and $55.2 billion in liabilities. In addition, despite earning $48.5 billion in revenues that year, the company had a net loss of $16.8 billion.

These numbers, however, only tell part of the story. Following World War II, Chrysler was known for its well-engineered cars. However, by the late 1970s, the company began having financial troubles that resulted in a bailout from Congress. Chrysler paid off its loans in the early 1980s due, in large part, to the success of its minivans and fuel-efficient K-cars. In 1987, Chrysler bought the No. 4 automaker, American Motors.
Unfortunately, the consolidation of the two companies, with resulting business difficulties, led to Chrysler being restructured.\textsuperscript{63} By the 1990s, Chrysler came roaring back again with the popular Dodge Viper sports car and its Jeep lineup.\textsuperscript{64} In 1998, Chrysler was acquired by Daimler-Benz of Germany and spent the 8 years that followed as DaimlerChrysler.\textsuperscript{65} By 2007, inconsistent financial results and pressure from German shareholders prompted Daimler to find a buyer and eventually sell the company to Cerberus Capital Management, a large investment fund.\textsuperscript{66} Although the company’s CEO at the time, Robert L. Nardelli, vowed to make Chrysler strong again under the new ownership, the sales slump brought on by the Financial Crisis in 2008 would prove to be too much for the company to withstand, and bankruptcy became nothing short of inevitable.\textsuperscript{67}

2. General Motors

Before the Financial Crisis, General Motors was the largest auto manufacturer in the world, producing nine million cars in 34 countries.\textsuperscript{68} In 2008, the 101-year-old company had 463 subsidiaries with 234,500 employees, 91,000 of whom were American.\textsuperscript{69} The company also provided health-care and pension benefits for more than 493,000 retired workers.\textsuperscript{70} In the United States, the company spent more than $50 billion a year buying parts from its network of 11,500 vendors and paid $476 million in monthly

\textsuperscript{63} Maynard, supra note 59.
\textsuperscript{64} Id.; James Bennet, \textit{The Designers Who Saved Chrysler}, N.Y. TIMES Jan. 30, 1994, at F1.
\textsuperscript{67} Maynard, supra note 59. Post-bankruptcy, Chrysler emerged a new entity with the United Autoworkers Trust, Fiat, the U.S. Treasury, and the Canadian government each owning an equity stake in the company of 55 percent, 35 percent, 8 percent, and 2 percent, respectively. Warburton, supra note 50, at 535-536.
\textsuperscript{69} A Giant Falls, supra note 68.
\textsuperscript{70} Id.
salaries.\textsuperscript{71} To go along with its big spending, General Motors also had $172 billion in liabilities and only $82.2 billion in assets.\textsuperscript{72} To stop the bleeding, in 2009, General Motors closed 11 factories, 40 percent of its 6,000 dealerships, and cut more than 20,000 jobs.\textsuperscript{73} Unfortunately, these measures failed to suffice and, on June 1, 2009, General Motors filed for Chapter 11 bankruptcy protection, triggering the largest industrial bankruptcy in U.S. history.\textsuperscript{74} The bankruptcy filing came just months after the Obama Administration had “laid out a framework for General Motors to achieve viability that required the Company to rework its business plan, accelerate its operational restructuring and make far greater reductions in its outstanding liabilities.”\textsuperscript{75}

The issues for General Motors, however, began well before the Financial Crisis.\textsuperscript{76} From 1983 to 2008, the company’s market share fell from close to 45 percent down to nearly 22 percent.\textsuperscript{77} Asian competitors, such as Toyota, were making better quality cars more efficiently and at lower costs.\textsuperscript{78} In response, General Motors began to use various cost-cutting techniques to remain competitive.\textsuperscript{79} These cost-cutting techniques resulted in the company producing lower quality vehicles, which, over time, became less attractive to customers.\textsuperscript{80} As demand for the company’s vehicles tumbled, so did the

\begin{footnotesize}
\textsuperscript{71} Id.
\textsuperscript{72} Id.; see Insolvency, Black’s Law Dictionary 916 (10th ed. 2014) (explaining “balance-sheet insolvency” where liabilities exceed assets); see also Kerr, supra note 68. One hallmark of insolvency is whether a “debtor’s liabilities exceed its assets.”.
\textsuperscript{73} Kimberly Amadeo, \textit{Auto Industry Bailout: Was the Big 3 Bailout Worth It?}, \textsc{Balance} (Nov. 27, 2018), https://www.thebalance.com/auto-industry-bailout-gm-ford-chrysler-3305670 [https://perma.cc/XPC5-R7L7].
\textsuperscript{74} A Giant Falls, supra note 68; Chris Isidore, \textit{GM Bankruptcy: End of an Era}, \textsc{CNN Money} (June 2, 2009), http://money.cnn.com/2009/06/01/news/companies/gm_bankruptcy/ [https://perma.cc/FC2K-D8PH] [hereinafter “GM Bankruptcy: End of an Era”].
\textsuperscript{76} A Giant Falls, supra note 68.
\textsuperscript{77} Id.; see \textit{GM Bankruptcy: End of an Era}, supra note 74 (noting the sharp decline in GM’s market share in the last quarter of the 20th century).
\textsuperscript{78} A Giant Falls, supra note 68; cf. Sharon Silke Carty & USA Today, \textit{7 Reasons GM Is Headed to Bankruptcy}, ABC News (May 31, 2009), http://abcnews.go.com/Business/story?id=7721675 [https://perma.cc/C8CP-C7ZC] (arguing that GM’s discontinuation of its EV1 electric car program allowed Toyota to take the lead in the market for fuel efficient cars with the Prius).
\textsuperscript{79} A Giant Falls, supra note 68.
\textsuperscript{80} Id.
\end{footnotesize}
price the company could ask for its vehicles.\textsuperscript{81} To increase revenue, the company’s management kept production high, maintained sales with costly dealership incentives, and offered heavily discounted fleets.\textsuperscript{82} Nevertheless, by the end of 2007, weakness in the U.S. housing market began infecting car sales as well.\textsuperscript{83} As housing prices fell, many consumers began putting off their purchases of new vehicles.\textsuperscript{84} Additionally, more willing buyers with lower credit ratings found it increasingly difficult to obtain financing to buy vehicles, whether new or used.\textsuperscript{85}

Worse yet, during this time, U.S. gas prices nearly doubled.\textsuperscript{86} As average gas prices soared to $4 per gallon, consumer demand for large pickup trucks and sport utility vehicles (SUVs) dissipated.\textsuperscript{87} Large pickup trucks and SUVs had been the bread and butter of the Big Three since their inception\textsuperscript{88}; however, as the Financial Crisis began, consumers wanted to swap out these gas-guzzlers for smaller, more fuel-efficient vehicles.\textsuperscript{89} As a result, the residual values for large pickup trucks and SUVs dramatically fell, leaving the finance arm of General Motors with heavy losses after these vehicles were returned, post-lease.\textsuperscript{90} After Lehman Brothers failed,\textsuperscript{91} vehicle markets around the world suffered and the U.S. market was hit the hardest.\textsuperscript{92} By the end of 2008, sales for cars and trucks were 35.5 percent lower than the prior year.\textsuperscript{93}

Moreover, each year, General Motors diverted billions of dollars away from the development of new models to, instead, pay the health care costs of retired union workers.\textsuperscript{94} These health care costs added $1,400 to the total

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{81} Id.
\item \textsuperscript{82} Id.; see also Carty & USA Today, \textit{supra} note 78 (contending that cash-back programs, 0 percent financing, and generous rebates led to deal-focused rather than car-focused marketing and drastically decreased the residual value of GM vehicles).
\item \textsuperscript{83} \textit{A Giant Falls}, \textit{supra} note 68.
\item \textsuperscript{84} Id.
\item \textsuperscript{85} Id.
\item \textsuperscript{86} Id.; see Bill Powell, \textit{Gas Prices Dropping: The Good News and Bad News}, \textit{TIME} (Oct. 14, 2008), http://content.time.com/time/business/article/0,8599,1850413,00.html [https://perma.cc/NW5M-PQJ8] (noting the price of gas in 2007 was approaching $5 per gallon in many parts of the United States).
\item \textsuperscript{87} \textit{A Giant Falls}, \textit{supra} note 68; Ken Bensinger, \textit{Car Leasing Runs out of ($4-a-gallon) Gas}, \textit{L.A. TIMES} (July 26, 2008), http://articles.latimes.com/2008/jul/26/business/fi-carleases26 [https://perma.cc/M95C-67YA].
\item \textsuperscript{88} \textit{A Giant Falls}, \textit{supra} note 68.
\item \textsuperscript{89} Id.; Bensinger, \textit{supra} note 87.
\item \textsuperscript{90} \textit{A Giant Falls}, \textit{supra} note 68.
\item \textsuperscript{91} See \textit{supra} notes 5-9 and accompanying text.
\item \textsuperscript{92} \textit{A Giant Falls}, \textit{supra} note 68; Bensinger, \textit{supra} note 87.
\item \textsuperscript{93} \textit{A Giant Falls}, \textit{supra} note 68; Bensinger, \textit{supra} note 87.
\item \textsuperscript{94} \textit{A Giant Falls}, \textit{supra} note 68; Silke, \textit{supra} note 78.
\end{enumerate}
\end{footnotesize}
cost of each vehicle produced—and were costs that the company’s Asian and European competitors did not have to sustain. By 2009, General Motors had lost more than $80 billion despite four years of restructuring efforts and was too weak to carry on without receiving billions of dollars along with a bankruptcy from the U.S. government.

3. Ford

Perhaps the strongest of the Big Three, Ford was able to withstand the Financial Crisis, but it did not do so unscathed. Although Ford was neither put into bankruptcy nor rendered a recipient of bailout funds as were its Big Three competitors, Ford did receive $5.9 billion in low-cost government loans from the U.S. government during the same time period in 2009 to fund the overhaul of its factories and the innovation of fuel efficient technologies. Moreover, Ford fully supported the Bush and Obama Administrations in providing U.S. federal dollars to Chrysler and General Motors. At the time, the U.S. government was the only entity that could save Chrysler and General Motors because the banks, which were dealing with their own financial crises, were unwilling to risk private capital to assist the two ailing U.S. automakers.

According to Steven Rattner, the former head of the Presidential Task Force on the U.S. Auto Industry in 2009, “Ford would have closed because it would not have been able to get parts, because the parts industry was in arguably worse shape than the assemblers.” Moreover, the former Ford CEO, Alan Mullaly, echoed Rattner’s sentiments stating, “if GM and Chrysler had gone into free fall, they could have taken the United States from a recession into a depression.” As such, Ford became an indirect beneficiary of the bailout. Not surprisingly, Mullaly sat shoulder to

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95. A Giant Falls, supra note 68.
96. Id.
99. See supra notes 2-13 and accompanying text.
100. See Keane, supra note 98 (explaining Ford avoiding the failure experienced by General Motors and Chrysler as a result of President Barack Obama’s administration’s policies).
101. Id.
102. Id.
103. See, e.g., FORD MOTOR COMPANY, FORD MOTOR COMPANY BUSINESS PLAN
shoulder with the other CEOs of the Big Three when those three men went to Capitol Hill in 2008 to plead their case for, in effect, a $25 billion transfusion of industry-saving funds.\footnote{104}

On the company level, Ford also took some additional steps to avoid the fate of Chrysler and General Motors.\footnote{105} In particular, Ford had positioned itself to abstain from the bailout because, in the years preceding the Financial Crisis, the company had restructured its business side operations and pledged most of its assets to obtain favorable long-term financing.\footnote{106} With little success, Ford also had tried to consolidate its large and concentrated dealership system.\footnote{107} In 2005, Ford (together with its subsidiaries Lincoln and Mercury) had 4,396 dealers in total with 2,242 of those in its largest 130 markets.\footnote{108} In its business plan submitted to the Senate Banking Committee in 2008, Ford planned to reduce the overall number of its dealerships to 3,790 with 1,875 in its largest 130 markets.\footnote{109} These efforts, however, cost the company millions of dollars because many of the affected dealers exercised

\textit{Submitted to the Senate Banking Committee 5 (2008), available at https://bigthreeauto.procon.org/sourcefiles/Ford_Motor_Company_Business_Plan.pdf [https://perma.cc/3MBZ-8HJ6] [hereinafter “FORD BUSINESS PLAN”] (stating that the U.S. automotive “industry is an interdependent one, with broad overlap in supplier and dealer networks, [and that] the collapse of one or both of [Ford’s] domestic competitors would threaten Ford as well.”).}

104. See Muller, supra note 97 (describing Ford’s criticism of GM and Chrysler in an advertising campaign); see also Josh Levs, Big Three Auto CEOs Flew Private Jets to Ask for Taxpayer Money, CNN (Nov. 19, 2008), http://www.cnn.com/2008/US/11/19/autos.ceo.jets/ [https://perma.cc/N3NJ-YW9F] (describing the frustrations expressed by lawmakers towards the CEOs of the Big Three who flew private jets to request taxpayer bailout money). Ironically, the three CEOs came under a sandstorm of harsh criticism when each of the three chose to fly to the hearing before Congress to beg for taxpayer money on corporate-sponsored private jets. \textit{Id.} One U.S. Representative commented that, “[t]here is a delicious irony in seeing private luxury jets flying into Washington, D.C., and people coming off of them with tin cups in their hand, saying that they’re going to be trimming down and streamlining their businesses . . . [i]t’s almost like seeing a guy show up at the soup kitchen in high hat and tuxedo.” \textit{Id.} It was estimated that each of the three round trip private jet flights cost their respective companies $20,000 each. \textit{Id.} In contrast, a typical round trip commercial flight from Detroit to Washington, D.C., would have cost each company about $500 per CEO. \textit{Id.}


106. \textit{Id.}

107. \textit{Id.}; see also FORD BUSINESS PLAN, supra note 103 (stating that Ford believes that its consolidation efforts have increased its financial strength). In its 2008 business plan, Ford acknowledges that it is acutely aware that its supply base, labor structure, and dealer network, among other factors, are sized for an industry and a market share that it, along with General Motors and Chrysler, can no longer support. \textit{Id.} at 5.

108. FORD BUSINESS PLAN, supra note 103, at 11.

109. \textit{Id.}
their termination rights under state franchise laws and sought compensation from Ford for unlawfully terminating their dealerships.\textsuperscript{110} Similarly, industry-wide attempts to have dealers voluntarily consolidate met much resistance, as most dealers sought to maintain and protect their own individual business interests.\textsuperscript{111} Thus, dealer saturation has always plagued Ford and other members of the Big Three,\textsuperscript{112} and eliminating dealer saturation may be the key to each company’s long-term sustainability.

II. THE U.S. FRANCHISE DEALER SYSTEM AND WHY IT IS A PROBLEM FOR THE BIG THREE

We now examine the business model utilized by the Big Three. In particular, we analyze the franchise dealer system, the legal and business mechanics that govern the system, and the perpetual complexities and pitfalls of that system.

A. The Franchise Dealer System

Historically, U.S. auto sales have been conducted via the machinery of franchising.\textsuperscript{113} As a business model, franchising is a system of marketing and distribution whereby an independent businessperson, the franchisee, is granted certain legal rights to market and sell the goods and services of another, the franchisor, in accordance with established standards and practices.\textsuperscript{114} Under a typical franchising system, the franchisor obtains new sources of capital, contracts with self-motivated entrepreneurs to sell its

\begin{footnotesize}
\textsuperscript{110} Id.
\textsuperscript{111} Dunne et al., supra note 105.
\textsuperscript{112} See Linebaugh, supra note 32 (explaining that domestic-brand dealers face the problem of there being so many of them). For example, in the case of General Motors, the company had 6,426 U.S. dealers in 2008 while its Japanese competitor, Toyota, had only 1,461 U.S. dealers. Id. Despite having significantly less dealers, Toyota’s U.S. sales still equaled about 85 percent of the sales for General Motors. Id.
\textsuperscript{113} See Carla Wong McMillian, What Will It Take to Get You in a New Car Today?: A Proposal for a New Federal Automobile Dealer Act, 45 Gonz. L. Rev. 67, 69 (2009) (describing the over-dealered market, poor product quality, and labor costs as reasons for the failures of the automotive industry, which is historically based on a relationship shared between dealers and manufacturers).
\textsuperscript{114} Robert W. Emerson, Franchise Terminations: Legal Rights and Practical Effects When Franchisees Claim the Franchisor Discriminates, 35 Am. Bus. L.J. 559, 559 (1998) [hereinafter “Franchise Terminations”]; see also Dean Fournais, The Inadvertent Employer: Legal and Business Risks of Employment Determinations to Franchise Systems, 27 Franchise L.J. 224, 224 (2008) (explaining while it is generally understood that franchise relationships are not strictly governed by employment law tests, there are certainly risks that employment determinations present to the business model of franchising).
\end{footnotesize}
products and services, and expands its business into new distribution markets. In contrast, the franchisee acquires products, know-how, brand name, and the stability of a larger enterprise without the associated risks and pressures of building a business from scratch. In a sense, the franchisee is able to gain the added benefit of, and piggyback on, the better name and product recognition of the franchisor’s brand. Moreover, the franchisor requires the franchisee to make significant investments in the franchised business and facilities, which, in turn, provides the franchisee additional motivation—perhaps even desperation—to succeed. Indeed, having some skin in the game may incentivize the franchisee to make better business decisions. Finally, the franchisee likely will know about the local market

115. *Franchise Terminations, supra* note 114, at 559–60.
116. *Id.* at 560.
118. Robert W. Emerson, *Franchise Contract Interpretation: A Two-Standard Approach, 2013 Mich. St. L. Rev. 641, 691* (2013) [hereinafter “*Franchise Contract Interpretation*”] (describing a survey of 100 franchise agreements which found that 72 of them specifically provided that the franchisor can mandate franchisee improvements to the franchise location and that these modifications are to be entirely at the expense of the franchisee).
119. ROGER D. BLAIR & FRANCINE LAFONTAINE, THE ECONOMICS OF FRANCHISING 133 (2005); *see also* McMillian, *supra* note 113, at 86 (alluding to franchisees as local entrepreneurs who largely invest in their businesses and facilities, and this significant investment serves as motivation to make their businesses succeed).
120. Ostensibly better business decisions, however, may not always be in the best interests of the franchisor. For example, the franchisee may have an incentive to increase prices and reduce quality to maximize her own profits. BLAIR & LAFONTAINE, *supra* note 119, at 86. Such behavior may harm the profits of the franchisor as well as the franchise system. *Id.* As the franchisee begins to cut corners in terms of the quality of products and service she provides, customers may become alienated from the particular franchise location and seek alternatives. *Id.* Moreover, customers expect product quality and service to be uniform across different locations and may attribute the low-quality products and services to the franchise
and consumers and, as such, be more equipped than an out-of-state franchisor at selling the franchised products or services. Thus, when a franchising system is functioning properly, the relationship between the franchisor and the franchisee will be interdependent and mutually advantageous to both parties. Similar to a partnership, both the franchisor and the franchisee derive an economic benefit from the success of the individual franchise.

In the U.S. automobile context, the franchising system is composed of two parties: the manufacturer (the franchisor) and the dealer (the franchisee). Under this dealer system, the manufacturer is able to exert great control over the distribution of its vehicles without the added burdens and responsibilities of maintaining an agency relationship with the dealers.

system as a whole. Id.; see also McMillian, supra note 113, at 86; Robert W. Emerson, Franchise Goodwill: Take a Sad Song and Make it Better, 46 U. MICH. J.L. REFORM 349, 354-55 (2013) [hereinafter “Franchise Goodwill”] (discussing the “double-sided moral hazard” between franchisors and franchisees, i.e., franchisees desire to maximize profits or alternatively cut corners while relying on the franchise’s good reputation and the franchisors risk of opportunism).

121. McMillian, supra note 113, at 86.


123. See, e.g., Neptune T.V. & Appliance Serv., Inc., 462 A.2d at 600 (describing franchising as a method of doing business which entails the advantages of an integrated corporate network with those of individual business proprietorships); see also Kaeser Compressors, Inc. v. Compressor & Pump Repair Servs., Inc., No. 09-C-521, 2011 WL 1900175, at *989–91 (E.D. Wis. May 19, 2011) (discussing the “continuing financial interest” between franchisor and franchisee). Franchises are different from partnerships, however, in that profits and losses are not shared equally between the franchisor and franchisee and that one party is, in practice, “above” or otherwise leading the other: the franchisee follows a specific, franchisor-created format or style using the franchisor’s trademarks and brand name. GLADYS GLICKMAN, FRANCHISING §§ 2.01 & 2.03[7]-[8] (1982); see also Emerson & Parnell, supra note 122, at 355 (noting that economic performance of a franchise can be negatively impacted by political speech associated with the franchise name).


125. Id. at 1136; see Stephen M. Fox, Two Roads Diverged: Tesla, Interruption, and the Commerce Clause, 22 B.U. J. SCI. & TECH. 152, 155 (2016) (noting the power discrepancy
Moreover, the manufacturer is able to select the dealers who sell its vehicles, choosing only those with an impressive potential for cultivating the local market, achieving high sales, and servicing the vehicle products. In return, the dealer receives from the manufacturer the added capacity to maintain and strengthen a strong local retail business. In most instances, the manufacturer will also assist the dealer in effectively merchandising the vehicles. Furthermore, the dealer, like any franchisee, will gain increased prestige through having an affiliation with a large organization with national presence.

B. The Dealership Agreement

A franchising contract (the dealership agreement) generally governs the manufacturer-dealer relationship and outlines the rights and duties between both parties. For example, the dealership agreement may govern how the dealer sells and services the manufacturer’s products, meets both sales targets and customer service objectives, and performs certain warranty services. The dealership agreement may also govern the vehicles and the parts the manufacturer must supply to the dealer for sales and service, how between the dealer and the manufacturer).


127. Kessler, supra note 124 at 136.

128. Id.

129. Id.


132. See, e.g., Link v. Mercedes-Benz of North America, Inc., 788 F.2d 918, 929 n.10 (3rd Cir. 1986) (“These franchising documents contain several clauses relating to the supply and pricing of Mercedes-Benz parts. The Dealer Agreement provides as follows: ‘MBNA will sell to the Dealer and the Dealer will buy from MBNA Mercedes-Benz passenger cars, parts, and products and assume the obligation of selling and promoting the sale of Mercedes-Benz passenger cars, parts, and products in [a designated] nonexclusive area.’”).
the manufacturer reimburses the dealer for warranty services performed for customers, and the manufacturer’s right to terminate the franchise.

C. The Automobile Dealers’ Day in Court Act

The manufacturer-dealer relationship is also governed by federal and state laws that often add to or, in some cases, supplant the express terms of the dealership agreement. The Federal Automobile Dealers Franchise Act, more popularly known as the Automobile Dealers’ Day in Court Act (hereinafter, the “Day in Court Act”), is a federal law permitting dealers to sue a manufacturer for damages caused by its failure to act in good faith when performing or complying with the express terms of the dealership agreement or, alternatively, in terminating, cancelling, or otherwise not renewing the dealer’s franchise. Congress’ purpose in enacting the Day in Court Act was to establish a balance of power between manufacturers and dealers to curtail the heavy economic advantages of manufacturers that

133. See, e.g., In re Auto Dealer Services, Inc., 65 B.R. 681, 683 (Bankr. M.D. Fla. 1986) (“The dealer agreement required each dealer to use its best efforts to sell warranty agreements to persons who purchased new or used cars, to sell the service agreements without modification at the rates set by debtor, to collect the purchase price of the service agreement as the agent of debtor and to hold the proceeds in trust, to remit the proceeds to debtor bi-monthly, to provide service for properly authorized warranty repair claims and to bill debtor for this work within 30 days. In return, debtor was required to maintain and administer a warranty service program, to authorize repairs in an expedient and timely manner, to maintain detailed records as to each service agreement holder and for each dealer, and to honor the repair claims submitted by dealers as to authorized warranty work. From the proceeds held in trust, each dealer was allowed to withdraw an advance commission equal to 50 percent of the purchase price of the service agreement.”).

134. See, e.g., Chrysler Motors Corp. v. Thomas Auto Co., Inc., 939 F.2d 538, 541 (8th Cir. 1991) (describing a case in which Chrysler’s termination of the dealer’s franchise was ruled not to be in violation of state statutes governing relationships between automobile manufacturers and their dealers); Major Oldsmobile, Inc. v. General Motors Corp., No. 95-7585, 1996 WL 280452, at *3 (2d. Cir. May 17, 1996) (stating that if a manufacturer has a legal right to terminate a dealer agreement, its ulterior motivations for doing so are irrelevant); Dale Baker Oldsmobile, Inc., 794 F.2d at 220 (stating that termination rights flow from the dealer agreement); General Motors Corp. v. New A.C. Chevrolet, Inc., 91 F. Supp. 2d 733, 740 n.10 (D.N.J. 2000) (describing a manufacturer’s right to terminate a dealer agreement).

135. McMillian, supra note 113, at 70.


139. Randy’s Studebaker Sales, Inc. v. Nissan Motor Corp. in U.S.A., 533 F.2d 510, 515 (10th Cir. 1976).
enabled them to coerce and intimidate their dealers.\textsuperscript{140} In particular, Congress sought to prevent manufacturers from forcing dealers to accept automobiles, parts, accessories, and supplies, which the dealers did not need, want, or believe they could absorb in their markets.\textsuperscript{141} As such, the Day in Court Act provides dealers with judicial protection from such arbitrary treatment and creates a new cause of action, separate from more traditional contract claims,\textsuperscript{142} that allows judicial determination of the issues irrespective of any dealership agreement terms or provisions and manufacturer claims of waiver or estoppel.\textsuperscript{143} Thus, most effectively and as its name suggests, the Day in Court Act provides dealers with the opportunity to air their complaints and seek redress in court.

D. State Dealership Acts

In addition to the Day in Court Act, at the state level, many legislatures have enacted statutes that further govern the manufacturer-dealer

\textsuperscript{140} Colonial Ford, Inc. v. Ford Motor Co., 592 F.2d 1126, 1129 (10th Cir. 1979).

\textsuperscript{141} See Woodward v. General Motors Corp., 298 F.2d 121, 128 (5th Cir. 1962) (holding that the dealer did not breach the automobile franchise agreement and is not liable to the manufacturer); see also S. REP. NO. 2073, at 2 (1956) (noting the decline in auto production and sales). According to the Federal Trade Commission: “[M]otor-vehicle manufacturers, and, by reason of their great power, especially General Motors Corporation, Chrysler Corporation and Ford Motor Co., have been, and still are, imposing on their respective dealers unfair and inequitable conditions of trade, by requiring such dealers to accept, and operate under, agreements that inadequately define the rights and obligations of the parties and are, moreover, objectionable in respect to defect of mutuality; that some dealers, in fact, report that they have been subjected to rigid inspections of premises and accounts, and to arbitrary requirements by their respective motor-vehicle manufacturers to accept for resale, quantities of motor vehicles or other goods, deemed excessive by the dealer, or to make investments in operating plants or equipment without adequate guaranty as to term of agreement or even supply of merchandise; and that adequate provisions are not included for an equitable method of liquidation of such investments, sometimes made at the insistence of the respective motor-vehicle manufacture.” 1939 FTC ANN. REP. 26.

\textsuperscript{142} See Hoffman Motors Corp. v. Alfa Romeo S.P.A., 244 F. Supp. 70, 77 (S.D.N.Y. 1965) (holding that an Italian corporation manufacturing automobiles was denied its motion for dismissal for complaints made against it by a franchise dealer for violation of the Day in Court Act); see also Action Nissan, Inc. v. Nissan North America, 454 F. Supp. 2d 108, 117 (S.D.N.Y. 2006) (detailing a franchisee’s action against franchisor for violations of the Day in Court Act); S. Res. No. 2073, 84th Cong. (1956) (describing the need for Congressional action to protect dealers from the arbitrary abuses of manufacturers).

\textsuperscript{143} See Alfieri v. Willys Motors, Inc., 227 F. Supp. 627, 629-30 (E.D. Pa. 1964) (holding that pleadings and affidavits put forth by a former automobile dealer against a manufacturer under the Day in Court Act presented issues of the manufacturer failing to act in good faith); see also Blenke Bros. Co v. Ford Motor Co., 217 F. Supp. 459, 463 (N.D. Ind. 1963) (holding that a former automobile dealer’s action against a manufacturer, based on violations of the Day in Court Act and other violations, presented genuine issues of material fact).
relationship. In most states, it is unlawful for manufacturers to cancel or refuse to renew a dealer’s franchise without good cause.144 This “good cause” requirement is defined in each state’s dealership act.145 Depending on the statute, good cause can be found for a variety of reasons, including the dealer’s transferring of its ownership interest in the franchise without the manufacturer’s consent, misrepresentations by the dealer in applying for the


franchise, the dealer’s becoming insolvent, and the dealer’s continued engagement in unfair business practices despite the manufacturer’s warnings not to do so.\textsuperscript{146} Good cause can also be found where a franchisee has breached the material terms of the dealership agreement.\textsuperscript{147} In addition to good cause, some dealership statutes also provide dealers with the right to protest the termination of the franchise, allowing the dealer an automatic stay without requiring the dealer to file for injunctive relief.\textsuperscript{148} In such cases, the dealer will then have to make a \textit{prima facie} case showing that the termination was unlawful and, if the dealer meets this requirement, the burden of persuasion will then switch to the manufacturer to show that the termination was for good cause.\textsuperscript{149}

State dealership statutes also govern other, more detailed aspects of the manufacturer-dealer relationship. For example, in some states, in addition to being able to prevent their own terminations, dealers can also block the relocation or addition of another dealer within a certain mile radius of their franchise.\textsuperscript{150} Similarly, some statutes govern the sale or transfer of the

dealer’s franchise, despite express contractual terms within the dealership agreement stating that the franchise is non-transferrable and solely between the manufacturer and the dealer.\textsuperscript{151} Moreover, some dealership statutes restrict the manufacturer’s right of first refusal that is included in the dealership agreement.\textsuperscript{152} In most dealership agreements, a manufacturer has a right of first refusal that allows it to step into the shoes of a willing buyer in the event the dealer chooses to sell the franchise.\textsuperscript{153} Some courts in these states have interpreted the right of first refusal provisions to be in direct contravention of the transfer provisions of the state’s dealership act and, as such, have found them to be void.\textsuperscript{154} 

With respect to warranty services, in most instances, the manufacturer has specific repair and replacement obligations as warrantor of the vehicles.\textsuperscript{155} Some state laws, however, require the manufacturer to use

\textsuperscript{151} Richard L. Smith II, Franchise Regulation: An Economic Analysis of State Restrictions on Automobile Distribution, 25 J.L. & Econ. 125, 139 (1982). Under a typical dealership agreement, the manufacturer always retains the right to approve a potential sale of a franchise. Walter F. Forehand & John W. Forehand, Motor Vehicle Dealers & Motor Vehicle Manufacturers: Florida Reacts to Pressures in the Marketplace, 29 FLA. ST. U. L. REV. 1057, 1096 (2001). If the dealer chooses to sell the franchise, notice to the franchisor is required. McMillian, \textit{supra} note 113, at 76. However, under some state dealership acts, manufacturers are required to prove the sale, unless the manufacturer has a legitimate business reason not to approve the potential buyer. \textit{Id.} at 76-77.


\textsuperscript{153} McMillian, \textit{supra} note 113, at 78.


\textsuperscript{155} McMillian, \textit{supra} note 113, at 78.
dealers to perform these services, which in itself serves as an additional business advantage for potential franchisees to pursue an auto dealership venture. Moreover, some legislatures also require manufacturers to reimburse dealers, dollar for dollar, at whatever rates the dealers charge their retail customers. These laws represent a shift from typical manufacturer-dealer practices, where reimbursement obligations for warranty parts and labor would typically be provided in, and governed by, the dealership agreement.

State dealership acts also address how manufacturers may allocate new vehicles to dealers across the state. The purpose of these statutes is to prevent manufacturers from forcing dealers into purchasing unwanted vehicles and products while ensuring that manufacturers do not discriminate between dealers in the allocation of more desirable vehicles and products. In these states, manufacturers utilize a predetermined formula for allocating vehicles based on each dealer’s projected and actual sales.

Lastly, state dealership acts, in some cases, also govern the forum in which disputes between manufacturers and dealers may be heard and the laws that may be applied. For example, many states require special administrative boards and agencies to hear and oversee manufacturer-dealer disputes as well as potential violations of the state’s dealership act. In these instances, federal and state courts usually have concurrent jurisdiction.

156. Id.; see also Ala. Code § 8-20-4(3)(s)(2018) (illustrating Alabama’s requirement that manufacturers use dealers to perform warranty services).
158. Id. at 79. For parts, manufacturers have historically paid a pre-determined mark-up over the dealer cost for the parts. Id. For labor, manufacturers will typically reimburse dealers. Id. at 80.
159. Id. at 82; see also Fla. Stat. Ann. § 320.64(18)-(19), (22) (2018).
161. McMillian, supra note 113, at 82. Manufacturers in Florida are required to go a step further and provide each dealer with an “equitable supply” of new vehicles based on model, mix, or colors. Id.; see e.g., Fla. Stat. § 320.64(18) (2018) (prohibiting Florida auto manufacturers from unfairly or inequitably allocating products to dealers). The term “equitable supply,” however, is not defined in the statute and raises additional questions, including whether a dealer would be compared to only other Florida dealers when deciding what constitutes an “equitable supply,” and whether the size of the dealer should be taken into account when deciding what is “equitable” and what is not. McMillian, supra note 113, at 82-83.
163. McMillian, supra note 113, at 83.
with these special administrative boards and agencies, allowing the party to choose its forum. In the interest of fairness, these special administrative boards and agencies are usually composed of both manufacturer and dealer representatives. Similarly, some state dealership acts also regulate the law that is applied in a manufacturer-dealer dispute. Such dealership acts render the choice of law provisions in a dealership agreement (usually the law of the home state of the manufacturer) illegal or unenforceable, making the dealership act of that particular state applicable. Even where the choice of law provisions of the dealership agreement are enforceable, the dealer in the dispute will still fall under the auspices of the state dealership act, allowing the dealer to, once again, override any choice of law provisions in the dealership agreement.

Clearly, state dealership acts not only protect the dealers, but also indirectly promote the franchise dealer business model. The auto dealership industry thus may have more appeal for potential franchisees in jurisdictions where the legislatures offer broader and stronger protections for their businesses, and thus greater avenues for the franchisees’ success. Still, a common issue remains: how much voice may a franchisee have, and how much should he or she have, in setting the terms of a franchise agreement? Since it is the franchisor’s product, name, goodwill, and business model that is being contracted for use by the franchisee, it should not be surprising that the franchisor usually has most of the power (often, nearly all of the power) when executing a dealership agreement, thus giving rise to the legal and policy concerns accompanying contracts of adhesion. However, with

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164. Forehand, supra note 151, at 1066.
165. Id.
167. McMillian, supra note 113, at 84.
168. Id. at 84-85.
169. Franchise Goodwill, supra note 120 (discussing franchise network goodwill). The creation, maintenance, control, and ownership of goodwill in the franchise context is an ongoing issue. Clearly, in most instances the franchisor’s role, at least initially, in establishing and maintaining franchise network goodwill is predominant. Id.
170. Terms of franchise agreements tend to strongly favor the franchisor. See Franchise Contract Interpretation, supra note 118, at 688-701 (surveying 100 franchise agreements and evaluating the relative frequencies of certain types of terms across agreements). A number of courts have found franchise agreements to be, at least with respect to some characteristics, adhesion contracts “because there is a disparity in the bargaining power of franchisors versus franchisees.” GARNER, supra note 160, at § 8:38.
recourse at the federal level and more rights via state dealership acts, the auto
dealer-franchisee ordinarily should have fewer such concerns than the
franchisees in most other industries. Furthermore, this could still be a
regulatory “plus” for the manufacturer-franchisor, too. While manufacturers
may feel constrained by the state dealership acts, certainly the stronger
protections and rights for dealers can draw a bigger pool of potential dealer-
franchisees, with more franchise applicants, a possibly wider dispersal of
franchisee talent, and perhaps more competition for the manufacturer’s
business within the system’s own franchise network (intra-dealer bidding for
the franchisor’s favor). Of course, the complexities of managing franchise
relationships and operating under state dealership acts remains. Without
proper planning, dealers may prove unnecessary and expensive.

E. The Franchise Dealer System: An International Comparison

1. Japan

While American auto manufacturers simply tried to survive, Toyota,
with its superior automobiles and more efficient manufacturing processes,
thrived in all markets during the Financial Crisis, including the United
automobile manufacturer, giving Toyota a reason to oppose the bailout of its
two largest competitors.\footnote{172. Nick Bunkley, Toyota Ahead of G.M. in 2008 Sales, N.Y. TIMES (Jan. 21, 2009), htt
p://www.nytimes.com/2009/01/22/business/22auto.html [https://perma.cc/Y82N-LGW5].} In that same year, Toyota brought in $17 billion
dollars in profit, while General Motors lost $31 billion and begged for much
needed bailout sustenance.\footnote{173. Huemer, supra note 171, at 337-38.} With a seemingly superior understanding of
the market, and other aforesaid advantages as to cost of production and the
product itself, Toyota was able to capture customers that the Big Three had
failed to satisfy with their underperforming vehicles (poor quality, low resale
value, size needs, miles-per-gallon, or other standards of a shifting customer
demand).\footnote{174. Id.; see Bunkley, supra note 172; see also supra notes 77-95 and accompanying text.}

In Japan, dealers are significantly less independent than in the United
States.\footnote{175. James B. Treece, Japan’s Franchise System Favors the Factories, AUTO. NEWS (Sept. 25, 2006), http://www.autonews.com/article/20060925/SUB/60918045 [https://perma.cc/P9F5-TY9E].} Dealers in Japan are much more limited in negotiating with
manufacturers when they are unhappy. In 2004, for example, Mitsubishi dealers allegedly supported an exposé criticizing the lavish lifestyle of a Mitsubishi executive, in an attempt to combat new showroom and customer satisfaction standards. Furthermore, dealers often sell only one brand and are often wholly or partly manufacturer-owned. The Japanese Civil Code includes a duty for parties to act in good faith, and an agreement can be voided if it is too favorable to one party. However, these laws do not appear to grant franchisees independence that would be comparable to that of the United States. While this franchise structure has been criticized in the past as giving too few options to franchisees, some manufacturers have voiced opinions about adopting certain characteristics of Japanese dealer networks, especially in the wake of the Financial Crisis, including going smaller and having fewer franchise dealerships.

The U.S. franchise dealer system has been historically characterized by growth—the more franchises a franchisor can open up, the better. But following the Financial Crisis, U.S. manufacturers looked to Japanese manufacturers for ways to streamline operations and increase profitability.

176. Id.
177. Id. The exposé apparently had no long-term impact in terms of shifting the auto franchisor-franchisee balance of power in Japan. See id. (describing how the balance of power still primarily benefits auto franchisors in Japan).
178. Id.
180. Id.
182. Id.
183. Id. A similar trend was seen in the early 1980s when U.S. automobile manufacturers began adopting Japan’s “Just-In-Time” system to streamline manufacturing and supply processes. John Holusha, ‘Just-In-Time’ System Cuts Japan’s Auto Costs, N.Y. TIMES (Mar. 25, 1983), http://www.nytimes.com/1983/03/25/business/just-in-time-system-cuts-japan-s-auto-costs.html?pagewanted=all. In particular, under the Just-In-Time system, waste is cut because parts are supplied only as and when the manufacturing process requires them. Just-in-time, ECONOMIST (July 6, 2009), http://www.economist.com/node/13976392 [https://perma.cc/PPY8-8WNT]. This new system was improvement upon the existing “just-in-case” system that held part inventories for every possible eventuality, which resulted in wasted parts and the associated cost of wasted parts. Id. Currently, U.S. manufacturers have greatly benefitted from utilizing their own versions of the “Just-In-Time” system and, although not without its flaws, the cost savings of the system have been great for a variety of U.S. companies. Steven Banker, The Costs of Excess Inventory can be Huge, FORBES (Mar. 10, 2016), https://www.forbes.com/sites/stevebanker/2016/03/10/the-costs-of-excess-inventory-can-be-huge/#7519b5df5a90.
One major difference between Japanese and U.S. manufacturers is size. U.S. manufacturers have over 20,000 dealerships, while their Japanese counterparts have eaten up market share with only a few hundred dealers. One reason for that may be the franchisor-favored laws in Japan, a stark contrast from those seen in the United States. Boston Consulting Group, Bain Consulting, and others recommend shrinking the number of U.S. dealers to improve the overall health of the U.S. automobile market. How much the market will improve is still uncertain. General Motors estimated that it could save $1.1 million per closed dealership—Chrysler’s estimate was a much more modest $45,500. The difference is attributable to the companies’ conflicting views on volume of dealer incentives that they could eliminate. While U.S. franchise law protects the interests of franchisees and limits the circumstances in which the relationship can be terminated, bankruptcy proceedings have complicated the issue, allowing Chrysler and General Motors to terminate 1,454 and 789 franchisees, respectively, through 2014.

2. Europe

European automakers fared well during the Financial Crisis, particularly BMW, Audi, and Mercedes. In the first 6 months of the Financial Crisis, BMW sales rose 13 percent, Audi sales rose 20 percent, and Mercedes sales rose 15 percent worldwide, painting the picture that luxury cars were recession-proof. Interestingly, it was the higher end luxury vehicles that excelled the most, with the cars at the bottom of the price scale suffering. Another European automaker, Porsche, also had success throughout the recession, hitting record numbers in 2012.


186. See supra notes 175-181 and accompanying text.


188. Id.

189. Id.

190. Id.


192. Id.

193. Id. Mercedes smart car sales dropped 17 percent. Id.

194. Scott Deveau, Appetite Grows for Luxury Auto Brands, FIN. POST (Oct. 5, 2012),
At least some of this success is attributable to European franchise law. In the United Kingdom, for example, a manufacturer can decide to restructure its dealership networks to eliminate underperforming or undercapitalized dealerships.195 Therefore, while U.S. manufacturers had far too many franchisees and were often prevented by law from terminating these contracts when they proved unprofitable,196 European manufacturers were not subject to such stringent regulations and were able to shed this dead weight of unprofitability.197 In fact, European manufacturers are permitted to cancel a dealership contract if the manufacturer is not satisfied with the franchisee’s performance.198 Indeed, in France, while franchisees and distributors have a right to all information that is of decisive importance for their consent to enter a contract with a franchisor, manufacturer, or supplier,199 the 2015 comprehensive reforms of French economic regulation confirm that French distribution law, including automobile distribution, are subject to the market, communications, and networking realities of a 21st Century society.200 Similarly, in Germany, contract disputes between German automobile manufacturers and their dealers have traditionally been limited, with contractual terms drawn overwhelmingly in favor of the

http://business.financialpost.com/news/transportation/appetite-grows-for-luxury-auto-brands [https://perma.cc/5ZNB-EUKS]. One reason for this trend could be that the clientele for $100,000 cars tends to be less affected by the whims of the economy. Id.


196. See supra notes 68-168 and accompanying text.
197. Webb, supra note 195.
198. Id.
200. Reforms enacted in 2015 and known as “the Macron Law” due to its chief proponent, then French Economy Minister (and now French President, since May 2017) Emmanuel Macron. Loi 2015-990 du 6 août 2015 pour la croissance, l’activité et l’égalité des chances économiques [Law 2015-990 of August 6, 2015 for Growth, Activity, and Equal Economic Opportunities], JOURNAL OFFICIEL DE LA REPUBLIQUE FRANCAISE [J.O.] [OFFICIAL GAZETTE OF FRANCE], Aug. 7, 2015, p. 13537, art. 61. The actual effect of the Macron Law in all facets of French automobile distribution law, such as for acquisition and transfer of know-how, franchise renewals and terminations, competition law, and the bargaining for and interpretation of the dealership agreement, are all still to be determined. LOUIS VOGEL & JOSEPH VOGEL, DROIT DE LA DISTRIBUTION AUTOMOBILE 13-15 (2016).

Indeed, both Japanese and European auto manufacturers appear to be at an advantage, whether through more efficient production processes, favorable franchise laws, smaller dealership networks, or high-end consumer tastes, when compared to that of pre-bailout U.S. auto manufacturers.

III. DETROIT: A CURRENT PERSPECTIVE

We now examine the benefits and costs of “bailing out” an industry from an economic and policy perspective and whether the bailout actually worked. The bailout, as many commentators argue, was necessary to prevent the Financial Crisis from spiraling into an irreversible collapse of the U.S. economy.\footnote{Chris Isidore, 3 Answers to the Auto Bailout Debate, CNN MONEY (Sep. 6, 2012) http://money.cnn.com/2012/09/06/autos/auto-bailout/index.html [https://perma.cc/TMQ2-RLLA] [hereinafter “3 Answers to the Auto Bailout Debate”]; Maria Shao, Steven Rattner: The 2009 U.S. Auto Bailout Was Necessary, STAN. GRADUATE SCH. OF BUS. (Mar. 1, 2011), https://www.gsb.stanford.edu/insights/steven-rattner-2009-us-auto-bailout-was-necessary [https://perma.cc/KQ8X-HQFQ].} The bailout, however, did not come without its costs. Government intervention in any economy—while often necessary—prevents market forces from allocating resources efficiently. The bailout, as many argue, resulted in such a misallocation.

We cannot, however, go back in time. Speculating about what might have happened had Congress refused to bail out the Big Three, while an interesting exercise in economic and political theory, fails to remedy the
problems of a distressed or, at least, vulnerable auto industry that still remains today. The inefficiencies in governance, design, manufacturing, and distribution must be addressed. An analysis of more successful organizations, such as BMW and Toyota, and the more favorable distribution systems found in other jurisdictions, such as in Japan and Europe, provides insight into how the traditional U.S. auto industry can streamline operations for the 21st century.

A. The Bailout and its Costs

1. What Was It?

In November 2008, when the CEOs of the Big Three stepped off their private company jets and onto Capitol Hill (with hats in hand, of course) to ask the U.S. government for what would be billions to prevent the inevitable bankruptcies of Chrysler and General Motors, it was said that they did so not for their own sakes but for the good of the U.S. economy.\(^\text{206}\) At the time, Congress and the media were outraged with the CEOs, their poor stewardship of their companies, the likelihood that their companies would not be able to pay back the U.S. government and, in particular, their obvious lack of humility in choosing to fly private rather than coach.\(^\text{207}\) However, reality would set in and economists warned that a failure to act on the part of the U.S. government could—and would—lead to the loss of millions of jobs and a meltdown of an important sector of the overall U.S. economy.\(^\text{208}\) The U.S. government would eventually respond to the CEOs and provide their companies the bailouts, totaling more than $80 billion.\(^\text{209}\) In return, Chrysler and General Motors were able to avoid liquidation under Chapter 7 of the U.S. Bankruptcy Code and, instead, file under Chapter 11, allowing both companies to restructure while continuing to do business.\(^\text{210}\)

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\(^{206}\) See Huemer, supra note 171, at 335 (depicting the scene where CEOs of the Big Three head over to discuss potential bankruptcies of Chrysler and General Motors).

\(^{207}\) Id.

\(^{208}\) Id.; 3 Answers to the Auto Bailout Debate, supra note 205.

\(^{209}\) Huemer, supra note 171.

unequivocal act intended to evince good faith (and, certainly, much better public relations), the Big Three CEOs began attending congressional meetings, ironically, by car rather than jet.\textsuperscript{211}

The bailout of the U.S. auto industry was only the most recent in a long line of bailouts and rescue attempts by the U.S. government stretching back to the bailout of Penn Central Railroad in 1970.\textsuperscript{212} In 1980, the U.S. government bailed out the most troubled member of the Big Three, Chrysler,\textsuperscript{213} and, soon thereafter, bailed out a number of savings and loan banks in 1989.\textsuperscript{214} Subsequently, in 2001, the U.S. government bailed out the U.S. airline industry and then, once again, the U.S. financial sector in 2008.\textsuperscript{215} Accordingly, the response of the U.S. government to the U.S. auto industry was not surprising. Questions are raised, however, on a broader level, as to whether “bailing out” is the right strategy, at least in the long run.

2. The Hidden Costs of Bailouts and Other Governmental Intervention

Proponents of “bailing out” will point to two different but interdependent arguments for why bailing out is the right choice. First, proponents will argue that a bailout is necessary to save American jobs.\textsuperscript{216} Jobs, so the argument goes, keep our economy strong and allow the United States to keep pace and compete in an ever-changing global economy.\textsuperscript{217} Before the bailout, for example, it was estimated that the U.S. auto industry employed, both directly and indirectly, up to ten percent American workers.\textsuperscript{218} Moreover, by the end of 2007, the Big Three alone employed more than 240,000 employees with related U.S. vehicle and component firms, directly employing an additional 730,000 hourly and salaried

\textsuperscript{211} Huemer, supra note 171.
\textsuperscript{213} Gold, supra note 35.
\textsuperscript{214} Nankin & Kjellman, supra note 212.
\textsuperscript{215} Id.
\textsuperscript{217} See Huemer, supra note 171, at 336-337 (noting the positive impacts of jobs on the United States economy).
\textsuperscript{218} DUNNE ET AL., supra note 105.
employees across the United States.\footnote{Id.} That same year, 20,000 new vehicle dealers in the United States employed more than one million people and had sales totaling close to $700 billion.\footnote{Id.} Therefore, at least on the surface, the job numbers alone made it imperative for the U.S. government to act to help ensure U.S. employment and economic stability.\footnote{Id.}

Second, bailout proponents will argue, in the alternative, that even if saving jobs is not primary, the Big Three are simply “too big to fail.”\footnote{Id.} From this standpoint, the U.S. auto industry is considered much too connected to the overall U.S. economy to simply no longer exist. As such, a failure of the Big Three would bleed into other sectors and potentially cause an overall economic shutdown of the United States.\footnote{Id.} For example, pre-bailout, the Big Three were the largest purchasers of American steel, aluminum, copper, plastics, rubber, and computer chips.\footnote{Id.} Moreover, General Motors alone paid for the insurance of nearly one million Americans.\footnote{Id.} The Big Three also utilize and have interdependent relationships with a large number of suppliers and original equipment manufacturers essential to the vehicle production process.\footnote{Id.} These proponents suggest that the ripple effect of a failure of the U.S. auto industry would result in the loss of millions of jobs, reducing personal income in the United States by more than $275 billion with a government tax loss of $108 billion.\footnote{Id.} Simply put, the lowering tide would sink all boats.

Although these arguments have merit, the bailout provided only a short-term solution to a failing U.S. auto industry, a solution which should prove, at least in the long term, to be more consequential than effective. One reason

\begin{itemize}
    \item \footnote{Id.} Id. \footnote{Id.}; Kim Hill et al., Ctr. for Auto. Research, Contribution of the Automotive Industry to the Economics of All Fifty States and the United States 1 (2015), available at https://www.cargroup.org/publication/contribution-of-the-automotive-industry-to-the-economies-of-all-fifty-states-and-the-united-states/ [https://perma.cc/UTC3-N8LZ].
    \item \footnote{Id.} Id.\footnote{Id.}; Dunne et al., supra note 105.
    \item \footnote{Id.} See Alexander Kaufman, Too Big to Fail: From Lehman to GM to Maybe Detroit, Can the Bailouts Finally Stop, Int’l Bus. Times (July 27, 2013) (noting how the Big Three firms are too important for the economy to let them fail); Dunne et al., supra note 105 (emphasizing the importance of Big Three firms in the United States economy in addition to the jobs they provide).
    \item \footnote{Id.} Id.\footnote{Id.}
    \item \footnote{Id.} Id.\footnote{Id.}
    \item \footnote{Id.} Id.\footnote{Id.}
    \item \footnote{Id.} Id.\footnote{Id.}
    \item \footnote{Id.} Id.\footnote{Id.}
\end{itemize}
for this potential outcome is that bailout strategies prove to be problematic in the long run.

Government bailouts typically create a “moral hazard” in that a long-established policy of bailing out private parties, business interests, or industries can create an incentive for large corporations to take excessive risks. On a similar note, large corporations may be incentivized to engage in uncalculated risk taking. In business, the taking of risks can create the possibility of even larger profits. Typically, corporations will take risks where the expected losses do not far exceed the expected gains. Acting as a kind of balancing force, the specter of going bankrupt for taking excessive risks will constrain the risky actions of a large corporation. Uncalculated risks, even if not excessive, can work to the detriment of a large corporation on a smaller, shorter-term scale compared to ultimate bankruptcy, although continued “minor” setbacks can equally lead businesses, both large and small, into insolvency. However, when a large corporation knows that it can avoid liquidation with an always readily available safety net of a government bailout, the free fall as a result of excessive risk does not seem too far of a distance. As such, the large corporation can enjoy the benefits and profits of excessive or uncalculated risks without the corollary consequence of closing its doors and selling off its assets.

In these instances, it is not only the U.S. taxpayer or our policymakers that bear the brunt of a government bailout; the stakeholders of the large corporation, and the corporation, itself, also lose. As we saw with the bankruptcies of Chrysler and General Motors, both companies were expected to pay back every dime supplied by the U.S. government during the bailout. The two companies eventually re-emerged heavily indebted to the

228. See Huemer, supra note 171, at 338; see also Brett McDonnell, Don’t Panic! Defending Cowardly Interventions During and After a Financial Crisis, 116 PENN. ST. L. REV. 1, 65 (2011) (describing the negative effect of government bailouts such as creating a moral hazard for economic actors).

229. Huemer, supra note 171, at 338.

230. Id.

231. Id.

232. See id. (noting the how government bailouts allow firms take risks that they would not otherwise take); McDonnell, supra note 228, at 65 (depicting the trend for more aggressive decision making when government bailout is an option).


234. See Huemer, supra note 171, at 338 (noting how various actors bear the burden of government bailouts).

235. Id.; see also Steve Contorno, Obama Says Automakers Have Paid Back All the Loans It Got from His Admin ‘And More’, POLITIFACT (Jan. 22, 2015) http://www.politifact.com/
U.S. government.\textsuperscript{236} Furthermore, the shareholders of the two companies lost some or all of their individual ownership stakes.\textsuperscript{237} Last, but not least, the corporate officers and executives of the two companies lost their jobs.\textsuperscript{238} Thus, a government bailout does not fully protect those who lend money to, work for, or invest in a large corporation.\textsuperscript{239}

Second, contrary to inferences that may be drawn from the argument above, the primary function of a business is not to provide jobs.\textsuperscript{240} The primary purpose of a business is to produce valuable goods and services that consumers want to buy.\textsuperscript{241} The more valuable the product, the more consumers\textsuperscript{242} are willing to pay for it.\textsuperscript{243} Accordingly, the market price of a product can often be a good measure of its value.\textsuperscript{244} As a corollary to this idea, it is also true that the value of the resources used to produce the product

\begin{footnotesize}
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\item \textsuperscript{237} Huemer, supra note 171, at 338; see also Rick Newman, Who Will Lose from the GM Bankruptcy, U.S. NEWS & WORLD REPORT (May 19, 2009), https://money.usnews.com/money/blogs/flowchart/2009/05/19/who-will-lose-the-most-from-a-gm-bankruptcy [https://perma.cc/LAP5-HQK5] (noting the shareholder loss that was incurred from the re-emergence of Chrysler and General Motors).
\item \textsuperscript{239} Huemer, supra note 171, at 338 (noting the lack of protection the government bailout has on the actors who are affiliated with the firms); James Sherk & Todd Zywicki, Obama’s United Auto Workers Bailout, WALL ST. J. (June 13, 2012), http://www.wsj.com/articles/SB10001424052702303768104577462650268680454 [https://perma.cc/CBK2-GLES] (portraying the negative im-pact of government bailouts negative on lenders, investors and workers). In comparison, during the AIG bailout, the counterparties in AIG’s derivative contracts received 100 cents on every dollar of the more than $62 billion that AIG owed to them. Brady Dennis, Fed Criticized for Not Negotiating Harder with AIG Creditors, WASH. POST (Nov. 17, 2009), http://www.washingtonpost.com/wp-dyn/content/article/2009/11/16/AR2009111603419.html [https://perma.cc/9EFZ-ZILM].
\item \textsuperscript{240} See Huemer, supra note 171, at 339.
\item \textsuperscript{241} Id.
\item \textsuperscript{242} That is, a higher quantity both in terms of the overall number of market players (consumers) and their individual offering prices.
\item \textsuperscript{244} Huemer, supra note 171, at 339.
\end{itemize}
\end{footnotesize}
frequently dictate its market price. As such, this simple lesson in economics makes one point clear: a business whose end product is less valuable than the resources used to produce it is wasting valuable resources that could be better used elsewhere. A primary example of this is a company that is operating at a net financial loss because it is unable to sell its product at a high enough price to cover its costs.

In a free market, a company that is wasting resources, failing to produce valuable products, and operating at a net loss will inevitably be faced with two choices: change its business practices or go out of business. If it is the latter, these companies will be pushed out of the market and the resources they were consuming will be freed up for more efficient and profitable companies to use. Thus, the market naturally corrects itself and places limits on how much value a company can destroy.

On the other hand, when a company is bailed out, this natural correction mechanism is stymied. The government saves a business that would have otherwise failed and enables the misallocation of valuable resources to continue. Additionally, to effectuate a bailout, the government uses its own valuable resources that could have been allocated elsewhere. Although these businesses become profitable, they tend to be less efficient,
both before and after the bailout, than firms that never require a rescue from the U.S. government.\textsuperscript{254} One reason may be that the firms still retain some of the same characteristics that made them need a bailout in the first place (i.e. an inferior product line, organized labor, disproportionate legacy costs, etc.).\textsuperscript{255} Thus, while the bailed out businesses may not be destroying value (or at least not as much), they still may be using their resources less efficiently than other firms that would have replaced them if not for the bailout.\textsuperscript{256}

This misallocation of resources during a bailout can happen on two levels. First, there tends to be an ineffective use of capital.\textsuperscript{257} When the U.S. government rescues a business, it does so by lending money to the business.\textsuperscript{258} The U.S. government will raise loan money for the business by selling Treasury securities to corporate, individual, and foreign government investors.\textsuperscript{259} Therefore, in the case of the U.S. auto industry bailout, if the U.S. government had not raised $80 billion from Treasury securities and allowed the Big Three to fail, it is likely that those same investors would have invested in other markets, including other more efficient and more profitable private sector businesses.\textsuperscript{260}

Alternatively, labor can also be misallocated in the bailout context. If a large corporation is inefficient and, as a result, poorly allocates its resources, including labor, the company will likely consume more labor (or ‘provide more jobs’) than is necessary to produce its products.\textsuperscript{261} The employees may therefore be happy while the large corporation and overall market suffers,\textsuperscript{262} which means that the joy of these workers is, of course,

\begin{footnotes}
\item[254] When was the last time Microsoft needed a bailout? How about Google? Nike? Apple?\textsuperscript{255} See Huemer, \textit{supra} note 171, at 344 (noting the increased risk of repeat bailouts due to retention of inadequate business characteristics); \textit{Dunne et al., supra} note 105 (noting an expectation of further loans where corporate distress exists following a bailout loan); \textit{see also supra} notes 43-96 and accompanying text.
\item[257] Huemer, \textit{supra} note 171, at 340; Marlow, \textit{supra} note 256, at 80.
\item[258] Huemer, \textit{supra} note 171, at 340; Marlow, \textit{supra} note 256 at 80.
\item[259] Huemer, \textit{supra} note 171, at 341.
\item[260] \textit{Id.; see also} Shuman, \textit{supra} note 250 (noting that, “The persistence of the belief that Daewoo and the other giant Korean conglomerates were too big to fail led many bankers and bond investors to toss billions at them no matter how loony their business plans or unprofitable their projects. Money was wasted in unproductive ways.’’).
\item[261] Huemer, \textit{supra} note 171, at 341.
\item[262] \textit{See id.} at 341-342 (noting that in cases of corporate inefficiency, employees should be laid off so that they may have the opportunity to procure more productive employment).
\end{footnotes}
temporary. From the overall, societal outlook, a loss of jobs is sometimes necessary to reallocate scarce labor resources to more profitable and efficient businesses or perhaps to other industries.\textsuperscript{263} Thus, the notion that a corporation is “too big to fail” may not always be true.\textsuperscript{264} In the case of the U.S. auto industry, it was thought that if Chrysler and General Motors failed, then so would their suppliers and, as a result, so would other manufacturers that use their suppliers, leaving millions out of work.\textsuperscript{265} However, this argument presumes that those millions would not have been able to find other jobs and that those suppliers and manufacturers would not have just simply downsized to keep their businesses operating.\textsuperscript{266} Moreover, bailing out large corporations while allowing the free market to swallow up smaller businesses, in the end, causes a greater concentration within one industry and, as such, perpetuates “too big to fail.”\textsuperscript{267}

\textbf{B. A Postmortem on the Big Three: Did the Bailout Actually Work?}

Post-bailout, the Big Three have been revitalized. In the time since the bailout, the Big Three have made major moves towards higher quality products and lower labor costs.\textsuperscript{268} As a result, they have closed the gap with

\begin{footnotesize}
\begin{enumerate}
\item[263.] Id.
\item[264.] See id. at 342 (repudiating the notion of “too big to fail” within the context of the automotive industry bailout); Marlow, supra note 256, at 78-79 (criticizing the bailout of inefficient businesses under the guise of market protection).
\item[265.] Huemer, supra note 171, at 342.
\item[266.] See Marlow, supra note 256, at 80 (countering the assumption that businesses would fail without bailouts); Huemer, supra note 171, at 342 (questioning the assumption that automotive suppliers would have gone bankrupt without the bailout protections that were imposed on manufacturers).
\item[267.] Huemer, supra note 171, at 344. It should be noted that even Congress takes issue with this notion of “too big to fail.” See Cheryl D. Block, Measuring the True Cost of Government Bailout, 88 WASH. U. L. REV. 149, 153 (2010) (noting that the purpose of the Dodd-Frank Act was to end “too big to fail”). In the preamble of the Dodd-Frank Wall Street Reform and Consumer Protection Act (more popularly known as the “Dodd-Frank Act”), Congress announces that the purpose of the law is “[t]o promote the financial stability of the United States by improving accountability and transparency in the financial system, to end ‘too big to fail’, to protect the American taxpayer by ending bailouts, [and] to protect consumers from abusive financial services practices[,]” 12 U.S.C. § 5301, §§ 5481-5603 (2010). Indeed, the Dodd-Frank Act was a remarkable political and policy achievement that provided new consumer protections as well as increased accountability and transparency for Wall Street. Block, supra note 267 at 154; see Robert W. Emerson, Franchises in a Fringe Banking World: Striking the Balance Between Entrepreneurial Autonomy and Consumer Protection, 46 AKRON L. REV. 11-12, 33, 34 & 38-39 (2013) (discussing Dodd Frank Act and impacts on some franchisee financing, generally).
\item[268.] Bennett, supra note 172.
\end{enumerate}
\end{footnotesize}
their foreign competitors.\(^{269}\) Since 2009, the number of manufacturing jobs in the auto industry has increased 41 percent, increasing from 623,300 to 879,300 jobs.\(^{270}\) Moreover, the Big Three are regaining market share. In 2014, the Big Three had about 45.1 percent of the U.S. auto market, a near two percent increase from 2009 numbers, but still below their pre-crisis market share of 50.5 percent.\(^{271}\) Since 2009, the Big Three have also created 640,000 auto industry jobs to complement record sales for each of the companies in both 2015 and 2016.\(^{272}\)

One of the ways the companies have advanced the most is through renegotiation of their labor contracts, a critical factor in not just their economic well-being, but that of the nation as a whole. Taking into account the significant amounts paid on legacy costs, with healthy bottom lines across the board, the Big Three are responsible for three percent of the American economy, are the largest source of manufacturing jobs, and are one of the largest American exporters.\(^{273}\) With a move towards manufacturing compact cars, $18 billion per year going to research and development,\(^{274}\) and the recent recalls from Toyota,\(^{275}\) it is expected that the Big Three will continue to grow.

On an individual level, each company is seeing varying success:

1. Chrysler

Emerging from bankruptcy, Chrysler has shown some signs of profitability.\(^ {276}\) Perhaps the most beleaguered of the Big Three pre-bankruptcy,\(^ {277}\) Chrysler had pre-tax earnings of $8.7 billion in 2017, although


\(^{270}\) Id.

\(^{271}\) Id.


\(^{274}\) Id.

\(^{275}\) Bennett, *supra* note 172.

\(^{276}\) Id.

sales were down nearly eight percent. In comparison, General Motors and Ford earned $12.8 billion and $8.4 billion, respectively, in pre-tax profits in 2017. A closer look at Chrysler over the last few years, however, reveals that the company has undergone many organizational changes to improve its profitability. In January 2014, the company became a wholly-owned subsidiary of Fiat Chrysler Automobiles (hereinafter, “FCA”) and consolidated its various holding companies into one single entity the following year. Without the tax gains from these 2014 and 2015 organizational changes, the company would have seen, for example, only about $312 million in profits in the first quarter of 2015, down from $486 million in the same quarter of the previous year. Although the company cited having to pay fines to the National Highway Traffic Safety Administration and various debt payments as the reason for the company’s up and down financial woes, a historical review of the company’s profit margins reveal much deeper issues.

On a general level, profit margins indicate the percentage of a company’s sales that it is able to retain after expenses. The profit margin of a company indicates how well the company is doing compared to industry competitors. Profit margins are especially important for automakers because they affect the company’s stock price, borrowing power, and ability to withstand an economic downturn that can quickly turn narrow profit margins into multi-billion dollar losses. For Chrysler, the company earned


281. Id.

282. Id.


284. See id. (discussing profit margin as a representation of company performance).

American markets in 2016.296

In an effort to increase its profit margins, the company has reduced dealer discounts and is developing strategies to better manage its vehicle production and product inventories.297 Additionally, the company closed two sedan plants in the Midwest to convert them to plant facilities for light trucks models, including the RAM 1500 pickup truck, which typically has a higher profit margin than the company’s sedans.298 The company has also sought to increase its market presence in Europe and in China, although the company was a latecomer to China, the world’s largest automotive market.299 Despite rumors, however, that Chrysler was seeking to sell parts of its company, including the Jeep brand, to Chinese automakers and investors, the company has chosen to remain independent and partner with Chinese automakers to deliver the Jeep brand to the Chinese market.300

As one solution to Chrysler’s profitability issues, the CEO of FCA, Sergio Marchionne, and the chairman of FCA, John Elkann, have publicly stated that there needs to be a consolidation of the U.S. auto industry to increase profits as the costs of capital investment and the development of new cars for global markets continue to rise across the industry.301 As of February 2018, the top executives of both General Motors and Ford have forcefully denied any possibility of a merger, acquisition, or deal with Chrysler.302 Accordingly, it seems that even with the bailout and accompanying bankruptcy, Chrysler continues to struggle to remain profitable both domestically and worldwide. These issues do not seem likely to change any time soon303 as Chrysler meanders down the road toward its competitors Ford and General Motors earned higher profits than Chrysler).


297. Id.

298. Id.

299. Id.


301. See *FCA Hints at Plan to Boost Profit Margins*, supra note 286 (stating that Marchionne and Elkann both advocated for further consolidation in the automotive industry due to rising costs).

302. Id.

303. Some critics of Chrysler are more than skeptical about the company’s future performance. According to Bernstein Researcher, Max Warburton: “[FCA] appears to be fundamentally overvalued. It has very limited profitability, it is so loaded with debt it makes little in the way of earnings, it is burning cash and it is not able to pay dividends.” *FCA US*
third bailout.

2. General Motors

Although General Motors survived as a corporation through the bailout, that did not mean that the company came out unscathed: The CEO was replaced, thirteen of the company’s plants were shut down, and over 1,000 dealerships were closed as a result of the bankruptcy.\(^\text{304}\) Since then, General Motors, at least from a profits perspective, appears to be doing exceptionally well post-bailout. By 2011, General Motors was back in the game, reporting a record net income of $9.19 billion in 2011\(^\text{305}\) and a total of $22.6 billion in earnings as of 2014.\(^\text{306}\) In the fourth quarter of 2015, General Motors reported the best profit margin the company has seen in its 107-year history.\(^\text{307}\) During that quarter, the company earned a net income of $6.3 billion, or $3.92 per diluted share, up from a net income of $1.1 billion, or $0.66 per diluted share, in the fourth quarter of 2014.\(^\text{308}\) Moreover, with $9.8

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\(^{308}\) General Motors, *GM Reports Record Net Income of $9.7 Billion and Record EBIT-
million in total car and truck sales, primarily in the United States and China, General Motors boasted $9.7 billion in total net income in 2015, more than tripling its 2014 results. 309 2016 was no different when the company boasted a net income of $9.4 billion. 310 With banner years in 2015 and 2016, General Motors placed sixth on the Fortune 500 list of U.S. companies. 311 General Motors’ post-bankruptcy success still remains in stark contrast with the $100 billion in losses it sustained in the four and a half years leading up to its 2009 bankruptcy filing. 312 Although the U.S. Treasury Department and U.S. taxpayers lost $10.6 billion dollars as a result of the bailout and did not see a full “return” from General Motors on their investments, 313 General Motors is currently one of the forty most profitable companies in the United States, coming in above companies such as Verizon and American Express. 314

General Motors owes a great deal of its post-bailout profitability to a variety of changes at the company level designed to ensure that General Motors is poised and ready for the next nationwide recession. 315 From a financial perspective, by the end of 2015, General Motors had $20.3 billion in cash on hand, $12.2 billion in available credit lines, and only $8.8 billion


311. Fortune 500, FORTUNE (2016), www.fortune.com/fortune500/. For comparison, General Motors is more profitable than companies such as Verizon and American Express.


313. Id. The United States decided to buy General Motors stock instead of giving General Motors a loan. Id. When the stock price never rose to the level which would allow the Treasury to recoup its investment, the taxpayers lost out on that money. Id. By March 2014, the treasury had sold all of its stock in General Motors and had written off its remaining $826 million investment, making its losses on the General Motors bailout total $11.2 billion. Eric Beech, U.S. Government Says It Lost $11.2 billion on GM Bailout, REUTERS (Apr. 30, 2014), http://www.reuters.com/article/us-autos-gm-treasury-idUSBREA3T0MR20140430 [https://perma.cc/NJ85-7ZUE].


315. See John Rosevear, How General Motors is Preparing for the Next Recession, FOOL, http://www.fool.com/investing/general/2016/02/07/how-general-motors-is-preparing-for-the-next-reces.aspx [https://perma.cc/C9FK-59MD] [hereinafter “How General Motors is Preparing for the Next Recession’’ (stating that during an earnings presentation following the fourth quarter of 2015, the Chief Financial Officer of General Motors, Chuck Stevens, announced that the company was “very aware that downturns are difficult to predict” and stated that General Motors is “planning and running the business accordingly, in essence proactively managing the cycle.”).
in long-term debt. Moreover, from a strategic standpoint, the company has adopted a number of tactics to ensure its financial success for years to come. First, the company has started focusing on cost-efficiency and maximizing the company’s global scale. In support of this strategy, the company set a goal to cut its annual costs by $5.5 billion by the end of 2018. Second, the company has chosen to implement effective “capital deployment.” More specifically, the company has begun exiting markets that are no longer providing the company with viable returns. For example, the company has exited the troubled Russian market and discontinued the low-profit sales of inexpensive small cars such as Chevrolets in Europe. Third, the company has sought to reduce its variable costs by producing fewer vehicles. For example, in 2015, General Motors had 100,000 fewer vehicles in its inventory than it did in 2014. Additionally, General Motors stopped producing its less profitable brands of Hummer, Pontiac, Saturn, and Saab to lower costs and the company’s breakeven point—the number of industry sales required to cover the company’s costs.

In keeping with its long-term strategic plans, General Motors has sought to diversify the company’s business portfolio. In particular, GM Financial, Aftersales, OnStar, and global Cadillac are companies independent of the

316. Id.
317. Id.
318. Id. In the world of economics, the concept of “scale” or “economies of scale” refers to factors that cause the average cost of production to fall as the volume of the production increases. Economies of Scale, ECONOMIST (Oct. 28, 2008), http://www.economist.com/node/12446567 [https://perma.cc/87W3-PWQC]. For example, it might cost $3,000 to produce 100 copies of a magazine but only $4,000 to produce 1,000 copies of the same magazine. Id. Hence, the average cost of production per newspaper has fallen from $30 to $4 a copy because the main elements of producing the magazine (editorial and design) remain constant and are unrelated to the number of magazines produced. Id. These are economies of scale. Id.
320. How General Motors is Preparing for the Next Recession, supra note 315.
321. Id.
322. Id.
323. Id. General Motors was able to keep its costs flat (equal to the revenue earned from producing 10-11 million units), while it increased its post-recession sales to around 17 million units. Thus, the focus to lower volume was less intended to lower fixed costs than to decrease variable costs. Id.
324. Id.
325. Kiley, supra note 272.
326. How General Motors is Preparing for the Next Recession, supra note 315.
The automotive business cycle that will improve the mix and quality of profits for the company, from peak-to-trough.\textsuperscript{327} GM Financial, for example, now serves as a financing arm of the company, while OnStar is intended to improve ongoing customer retention and generate additional revenue streams by offering in-car services via 4G connectivity.\textsuperscript{328} Similarly, General Motors has sought to make its luxury Cadillac brand a direct rival to the German luxury-car giants.\textsuperscript{329}

Finally, General Motors decided to invest $500 million in Uber’s main competitor, Lyft.\textsuperscript{330} Together with Lyft, General Motors seeks to develop a network of on-demand autonomous vehicles, with General Motors a preferred partner for Lyft drivers.\textsuperscript{331} Those who do not own vehicles could pick up General Motors vehicles from rental locations across the country and earn money driving for Lyft.\textsuperscript{332} Moreover, General Motors, like Google, Ford, Tesla, and Uber, is also exploring the world of self-driving vehicles as a potential new market for innovation and investment.\textsuperscript{333}

Unfortunately, General Motors’ unprecedented financial success has not come without its own set of equally devastating pitfalls. On the criminal side, in September 2015, General Motors paid $900 million to settle criminal charges filed against the company related to its flawed ignition switch which has been linked to at least 124 deaths\textsuperscript{334} and considered one of the deadliest recalls in U.S. history.\textsuperscript{335} It was found that the ignition switch in some General Motors’ vehicles would shut off the car while it was being operated, disabling the airbag, power steering, and power brakes, and thereby putting drivers, passengers, and others at risk.\textsuperscript{336} General Motors admitted that its

\begin{itemize}
  \item[327.] Id.
  \item[328.] Id.
  \item[329.] Id.
  \item[331.] O’Brien, supra note 330.
  \item[332.] Id.
  \item[333.] Id.
  \item[336.] Id.
\end{itemize}
executives were aware of the ignition switch problem in February 2004, nearly a decade before the company began its first recall. This delay is what prompted the Justice Department to file criminal charges.

On the civil side, General Motors is slated to pay more than $600 million into a general relief fund to assist victims injured or killed as well as their families in connection with the faulty ignition switch. Luckily for General Motors (and only General Motors), a judge ruled in April 2015 that General Motors was shielded from liability for any claims arising before its bankruptcy and reorganization in 2009, effectively disposing of more than 140 lawsuits and saving General Motors between $7 billion and $10 billion in potential liability judgments. This ruling, however, did not absolve General Motors of having to pay $35 million to settle civil fines levied against it by federal regulators. In addition to the criminal and civil

337. GM Posts Biggest Profit Margin in 107-year History, supra note 307; see also Isidore & Perez, supra note 334 (explaining the settlement, General Motors CEO, Mary Barra, told employees “[p]eople were hurt and people died in our cars. That’s why we’re here today.”).
338. Id.
339. Id. This includes a relief fund that General Motors spokesperson, Jim Cain, described as “fair, compassionate, generous and non-adversarial.” Death Toll for GM Ignition Switch, supra note 335 The fund awarded those killed at least $1 million each, although some received more based on the victim’s income and the number of dependents he or she had. Id.
340. See Victor Morton, GM Bankruptcy Worth Billions in Faulty Ignition Switch Reprieve, WASH. TIMES, (Apr. 15, 2015), http://www.washingtontimes.com/news/2015/apr/15/gm-bankruptcy-worth-billions-faulty-ignition-switc/ [https://perma.cc/V6R3-ZZCT] (reporting that General Motors could not be sued for the deaths related to the company’s defective ignition switches); see also Isidore & Perez, supra note 334 (reporting that no General Motors executives were charged for the defective ignition switches). Under Chapter 11 of the United States Bankruptcy Code, once the court confirms a bankruptcy or reorganization plan, a debtor (here, General Motors) is discharged “from any debt that arose before the date of such confirmation.” 11 U.S.C. § 1141(d)(1)(A) (2010). Similarly, after court confirmation of a bankruptcy or reorganization plan, “the property dealt with by the plan is free and clear of all claims and interests of creditors, equity security holders, and of general partners in the debtor.” 11 U.S.C. § 1141(c) (2010). Moreover, creditor’s claims and any pre-plan confirmation rights of creditors survive only to extent that they are accounted for in the confirmed bankruptcy or reorganization plan. 11 U.S.C. § 1141(c) (2010). Unfortunately, for the faulty ignition switch claimants and victims, their claims were not included (or known to exist) when General Motors received its confirmed 2009 bankruptcy or reorganization plan from the court. See Pamela C. Maloney, Top Story—Motor Vehicles—S.D.N.Y.: Ignition Switch Defect Claimants Plan to Use MDL to Challenge New GM’s Bankruptcy Shield, WOLTERS KLUWER PRODUC TS LIABILITY LAW DAILY, 2015 WL 1950726 (C.C.H.) (May 1, 2015) (reporting that faulty ignition switch claimants intend to challenge in the multidistrict litigation court the bankruptcy court’s ruling barring claims against post-bankruptcy General Motors).
341. Isidore & Perez, supra note 334. In comparison, in 2014, Toyota agreed to pay $1.2 billion to settle a case related to its failure to recall cars despite reports of unintended acceleration. Id. Similarly, in 2013, JPMorgan Chase agreed to pay a record $13 billion fine
penalties, General Motors has recalled more than 30 million vehicles related to the faulty ignition switch, with the company paying about $4.1 billion in total repair costs.\footnote{342}{Id.}

Union and employee costs also still plague General Motors. Taking advantage of negotiating at a time of strong car sales and profits, the UAW in 2015 agreed to a four-year contract with the company.\footnote{343}{See Chris Isidore, UAW Approves GM Contract, CNN Money (Nov. 20, 2015), http://money.cnn.com/2015/11/20/news/companies/gm-uaw-contract-approved/ [https://perma.cc/ZM5N-E8F9] (announcing that the UAW approved a new four-year contract with General Motors).} Under the new deal, veteran autoworkers received their first raise in almost a decade.\footnote{344}{Id.} The deal also, over the course of eight years, closes a pay gap between veteran workers and those hired since 2007 (who were paid at a significantly lower pay scale).\footnote{345}{Id.} Additionally, the deal includes a signing bonus, profit sharing plan, and other lump-sum payments that, over time, will add up to tens of thousands of dollars in costs per worker to General Motors,\footnote{346}{Id.} a result similar to that of the pre-bailout company that we all know so well. For General Motors, only time will tell.

3. Ford

Ford, perhaps the only one of the Big Three not, at least arguably, to receive bailout funds,\footnote{347}{Muller, supra note 97.} appears to be doing well, although difficulties for the company remain on the horizon. Since 2009 and the low point of the recession, the company has steadily grown, as it has increased its U.S. sales and has agreed, in its most recent labor contracts, to invest $19 billion in U.S. plant facilities.\footnote{348}{Chris Isidore, Ford Plans Plant in Mexico with 2,800 Jobs, CNN Money (Apr. 5, 2016), http://money.cnn.com/2016/04/05/news/companies/ford-mexico-plant/ [https://perma.cc/D5QD-WE4V] [hereinafter “Ford Plans Plant in Mexico with 2,800 Jobs”].} Additionally, Ford has added 25,000 U.S. factory workers since 2009, giving the company a total of 55,300 workers and the most U.S. factory workers in the U.S. auto industry for the first time since the 1930s.\footnote{349}{Id.}

Ford has also been in the political limelight. In April 2016, Ford received flak from then presidential candidate, Donald Trump, when the
company announced plans to invest $1.6 billion to create a new small car plant facility in Mexico that would create 2,800 Mexican jobs, a move Trump called “an absolute disgrace.” The soon-to-be President then threatened, once elected, to impose steep tariffs on all Ford cars imported from Mexico to the United States. Ford, attracted to Mexico due to its lower wages and favorable trade laws, responded to Trump’s attacks stating that “there [was] not going to be any U.S. job effect as a result of this move” to Mexico. Moreover, the company stated that in moving its small car operations to Mexico, the company would improve the profitability of its small cars because Mexican wages are less than half the top pay of U.S. union workers who earn $29 an hour. Additionally, Ford CEO, Mark Fields, defended the company, stating, “[w]e are absolutely proud of what we do to contribute to economic development in our home country . . . . At the same time, we’re a multinational company and it’s really important for us to be competitive around the world.” Currently, some of Ford’s competitors, including Toyota, Kia, and Audi, are each in the process of opening major plant facilities in Mexico.

From a strategy standpoint, Ford is also hoping to devote its U.S. operations to truck and SUV lines, which have a higher price point that can withstand U.S. wages and allow the vehicles to remain profitable. Ford’s luxury trucks and SUVs are also in higher demand in the United States. While competitors are finding success in compact cars, Ford has been able to manufacture the number one selling vehicle in the country: the Ford F-

350. Id.
351. Id. Trump also said, “[w]hen I am president, we will strongly enforce trade rules against unfair foreign subsidies, and impose countervailing duties to prevent egregious instances of outsourcing. This will continue until we can renegotiate NAFTA to create a fair deal for American workers.” Id. Trump has warned that he will impose 35 percent tariffs on automakers, both domestic and foreign, for imports from Mexico, Canada, and Germany to force automakers to shift their production back to the United States. Trump, Detroit Automaker CEOs Trade Wish Lists, supra note 294.
353. Ford Plans Plant in Mexico with 2,800 Jobs, supra note 348.
354. Vlasic, supra note 352.
356. Vlasic, supra note 352.
357. Id.
358. Id.
series pickup trucks. Even though the trucks are the number one selling vehicle, they have not hit their pre-Financial Crisis numbers (940,000 in 2004 compared to the roughly 600,000 they sold in 2012), which has caused Ford to try to get consumers interested in their luxury car lines, such as Lincoln, to make up for the lost revenues.

Unfortunately, despite the economic wisdom and profitability that would flow from a factory making smaller automobiles in Mexico and increased output of larger, more expensive cars in the United States, Ford scrapped plans for the Mexican plant facility in January 2017, just weeks before Trump’s inauguration. In lieu of the plant facility in Mexico, the company instead would invest $700 million to expand its existing plant in Flat Rock, Michigan, creating 700 new U.S. jobs. Although some believed that political pressure from the incoming Trump Administration might have fueled Ford’s decision to scrap the plant facility, Fields denied such allegations and assured the public that the company did not “cut a deal with Trump” and that the decision was made for the betterment of the business.

In making the decision, Fields said that the company was “encouraged by the pro-growth policies President-elect Trump and the new Congress have indicated they’ll pursue . . . [and that the company] believe[s] [that] these tax and regulatory reforms are critically important to boost [the company’s] U.S.


360. Id.; see also Vlasic, supra note 352 (reporting that U.S. automakers are shifting to focus domestic production on high-profit vehicles).


363. Ford Scraps Plans for Mexico Plant, but Says It’s not Because of Trump, supra note 361.

364. Id. Ford’s rocky relationship with Trump is well-documented. While campaigning in November 2016, Trump falsely announced on Twitter that he was successful in convincing Bill Ford, chairman of Ford, to reverse the company’s plan to close a plant in Louisville, Kentucky and open up the same operations in Mexico. See Arthur Delaney, Trump Falsely Claims He Stopped Ford from Leaving Kentucky for Mexico, HUFF. POST (Jan. 3, 2017), http://www.huffingtonpost.com/entry/donald-trump-ford_us_582e6846e4b099512f821df4 [https://perma.cc/JN37-AUHH] (reporting that Ford never said it would close its Kentucky assembly plant). In reality, the company did not have any such plans to close the plant. Id.
competitiveness.”  

Although wage costs will be significantly higher in the United States than in Mexico, the company plans to make the capital expenditures necessary to improve the overall efficiency of the existing Michigan plant.

Beyond the prospect of moving operations to foreign nations, Ford has taken other measures to improve its competitiveness and diversify its business for years to come. In March 2016, the company launched its subsidiary, Ford Smart Mobility, to develop in-car connectivity, ride-sharing, and autonomous technologies. According to Fields, “We’re rethinking our entire business model. It’s no longer about how many vehicles we can sell, it’s about what services we can provide. We understand that the world has changed from a mindset of owning vehicles to one of owning and sharing them.”  

As a part of this new initiative, the company acquired a San Francisco-based crowdsourcing shuttle bus startup called Chariot and partnered with the city to provide thousands of human-powered bikes for a ride-sharing scheme. Similarly, the company has embraced the idea that driverless cars, Uber, and climate change will soon transform the automobile landscape. One of Ford’s strategies to cope with this new landscape is to invest in the development of fully autonomous vehicles. Currently, the company plans to have a fully self-driving car, without a steering wheel, accelerator, or pedals, by 2021, although the company’s production lags behind that of Google and other competitors in the autonomous vehicle space.

With regard to profits, Ford is doing somewhat well. In 2016, for example, the company’s total revenue totaled $151.8 billion up 2.2 billion

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366. Id.


368. Id.

369. Id.

370. Id. Ford also announced that it was interested in partnering with Lyft. Ohnsman, *supra* note 330.


372. Id. 2018 has also seen the emergence of another company in the driverless-car scene. See Neal E. Boudette, *Waymo, a Google Spinoff, Ramps Up Its Driverless-Car Effort*, N.Y. TIMES (Mar. 27, 2018), https://www.nytimes.com/2018/03/27/business/waymo-driverless.html [https://perma.cc/5J8U-B456] (reporting that Waymo plans to buy up to 20,000 electric cars from Jaguar Land Rover as it strives to put its ride service into operation within two years).
from the year prior, with $96.2 billion of that earned in North American markets.\textsuperscript{373} The company also reported pre-tax earnings of $10.4 billion, which was $200 million higher than expected and signified the automaker’s second-best earnings year since 2000.\textsuperscript{374} The downside, however, was that Ford’s net income was only $4.6 billion, a 38 percent year-over-year decline.\textsuperscript{375} According to the company, the significant loss of net income was the result of a $3 billion loss related to revisions to its retirement and pension plans, a number the company expects to be a one-time hit.\textsuperscript{376} Despite the company’s relatively strong earnings, shares in the company still seem to be trading in a narrow band in U.S. equity markets.\textsuperscript{377} Some commentators believe that this low trade volume of the company’s stock may be an indicator that smart money remains unconvinced that Ford would be able to successfully navigate another recession without outside help.\textsuperscript{378} The company also still owes the federal government $3.5 billion in connection with loans it received to overhaul its factories and develop fuel-efficient vehicles and technologies during the Financial Crisis which come due in 2022.\textsuperscript{379}

IV. TESLA: A SUSTAINABLE ALTERNATIVE TO AUTOMOBILE DEALERSHIP FRANCHISING

Although the Big Three have dramatically restructured their companies


\textsuperscript{375} Id.

\textsuperscript{376} Id.


\textsuperscript{378} Id.

and fought hard to remain competitive, post-bailout, Ford, and especially Chrysler, show signs of weak long-term sustainability. Additionally, the record profits we have seen from General Motors, post-bailout, has only been marred with billions of dollars in recalls, criminal penalties, and civil lawsuits. With the franchise dealer system and legacy costs still prevalent and, in effect, renewed, it seems only inevitable that the Big Three, or at least some of the Big Three, will need another bailout to avoid a collapse during the next significant recession or economic downturn—and, as we saw in 2009, if one or two go, the whole U.S. auto industry may go.

We propose an alternative to the inevitable. We propose that state laws prohibiting direct sales from auto manufacturers to consumers be changed to allow the Big Three to sell directly to consumers to remove the shackles of the franchise dealer system and increase the overall profitability and competitiveness of the Big Three in the global market. We think the famous 18th Century economist, Adam Smith, said it best:

[t]he natural effort of every individual to better his own condition . . . is so powerful, that it is alone and without assistance, not only capable of carrying on the society to wealth and prosperity but of surmounting a hundred impertinent obstructions with which the folly of human laws too often encumbers its operations.  

We believe that the direct sales model of Tesla may be that alternative.

A. Tesla: The History, the Controversy and the Back and Forth

New and controversial to the automobile industry scene is Tesla Motors, Inc. (“Tesla”), a U.S. corporation that combines automotive and energy technology to manufacture Tesla electric vehicles. Martin Eberhard and Marc Tarpenning founded Tesla in 2003. In its first few years of life, the Tesla team expended large amounts of money to create a production line for its electric sports cars. By the time the last quarter of 2007 came around, Tesla found itself in a financial crisis similar to that of the Big Three during the same time period. However, Tesla would not

380. ADAM SMITH, THE THEORY OF MORAL SENTIMENTS 9 (1777).
381. To learn about Tesla’s business model and products, go to http://www.teslamotors.com.
383. Id.
384. Id.; see also Cadie Thompson, The Christmas Miracle That Saved Tesla, TECH
only be able to survive, but also to thrive after the Financial Crisis, unlike the Big Three.  

Tesla was able to pull itself out of its financial hole through changes in management. First, the company’s management laid off 10 percent of Tesla’s employees to cut costs but thereafter obtained a new CEO who was able to invest $70 million in the start-up. After creating the Tesla roadster and family sedan models, Tesla accepted a $465 million loan from the U.S. government and, in contrast to the Big Three, Tesla paid off this loan in full in 2013, 9 years earlier than the maturity date. By going public on the NASDAQ stock exchange in 2010, Tesla was the first American car company to become publicly traded since Ford Motor Company in 1956.

Despite Tesla’s success as a newcomer to the auto industry, the car company faced some nearly insurmountable obstacles to its operations in the United States. The obstacles may be deemed ironic, in that Tesla’s business model actually adds a level of simplicity and transparency to the sales and marketing aspects of the industry by removing the middleman: the franchise dealer. That is, Tesla, as a manufacturer, directly sells its cars to consumers itself, rather than using a third-party dealer such as the Big Three and the majority of other domestic and foreign manufacturers. This innovative business model is accomplished through the establishment of

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386. Kumparak, Burns & Escher, supra note 382.

387. Id.


manufacturer-owned dealerships instead. A customer simply goes to a Tesla service center or online, uses Tesla’s online catalogue to pick her vehicle and its features and, within months, Tesla delivers the vehicle to the service center or the customer’s home or business. There is no franchise dealership middleman required. While this business model may seem harmless and, in fact, beneficial to consumers, in the United States, Tesla’s business model has been challenged and met with outrage by automobile dealers and dealership associations alike. Unfortunately for Tesla, these challengers have legislation and legislative history on their side, which will be explored below—although in a changing automotive legal arena, this may not remain the case for long.

In most states, state franchise laws explicitly prohibit manufacturers and producers from directly selling their vehicles to consumers at a physical store in the state. In fact, in 2002, right before Tesla came onto the scene, over forty states had this type of prohibitive law in place. For example, Florida Statute § 320.645 provides: “[n]o licensee, distributor, manufacturer, or agent of a manufacturer or distributor, or any parent, subsidiary, common entity, or officer or representative of the licensee shall own or operate, either directly or indirectly, a motor vehicle dealership in this state for the sale or service of motor vehicles.” The text of the Florida law is fairly representative of the broad textual language used by most state


394. Ohnsman, supra note 330.


The breadth of these laws makes it so Tesla can only sell vehicles directly to consumers in those states through an indirect medium, such as by phone or via the Internet, and thereby burden the consumer, who will only be able to view and test drive a Tesla vehicle if he or she travels to one of the few states that allow Tesla to establish physical stores or galleries. These statutes do contain several exceptions to the “no direct sales” rule, but none of the exceptions apply to a manufacturer, such as Tesla, seeking to establish a permanent sales location.

Cases arising under such laws that challenge Tesla’s ability to operate within a state have been brought to courts and legislatures under several legal theories. For example, in New York, a motor vehicle administrative board issued a permit to Tesla, which would have allowed the manufacturer to establish a manufacturer-owned dealership in New York, from which it could sell its vehicles. Dealer interest groups brought suit under a local law banning direct sales in New York, claiming that the permit issuance was unlawful; however, the case was dismissed on standing grounds before the merits of the case could be decided. Similarly, in Texas, Tesla initially

397. See Empie, supra note 395, at n.153 (listing the statutory language used in forty-two states).

398. Barmore, supra note 390, at 192.

399. Id. at 194 (“Limited exceptions are allowed for temporary operations, grandfathered sellers of used trucks or motor homes, and certain other narrow categories.”).

400. See, e.g., Tesla Motors Inc.’s Brief at 4, Tesla Motors Inc. v. N.J. Motor Vehicle Comm’n, No. A-3213-13T2 (N.J. Super. Ct. App. Div. Mar. 28, 2014) (challenging whether a law that only restricts the ability of a franchisor to compete against its own franchisees also applies to a manufacturer with no franchisees); H.B. 3351, 83d Leg. (Tex. 2013) (proposing to allow electric vehicle companies to own their own dealerships in Texas and amend current restriction on such companies as overly broad); S.B. 327, 2013 N.C. Sess. Laws 1 (proposing to amend N.C. Gen. Stat. Ann. § 20-286(11)(a) (2013) seeking to alter the definition of “dealer” as used in the statute to include a person who engages in sales activities using a computer or other communications facilities, hardware, or equipment at any location within the state to prevent Tesla from selling its vehicles online in the state).


402. See Rob Schwartz, Tesla, Vertical Integration, and Incumbent Legal Disadvantages in the New Car Retailing Market, 60 WAYNE L. REV. 567, 590 (2014) (discussing an action brought by a private automobile dealer and dealer’s association against Tesla and New York’s motor vehicle administrative board for issuing a license to Tesla to sell its cars through a wholly-owned dealership). These cases have been dismissed for lack of standing in other states as well. But see Amy Wilson, Tesla Reaches Deal to Keep 5 N.Y. Stores, AUTO. NEWS (Mar. 28, 2014), http://www.autonews.com/article/20140328/RETAIL07/140329848/tesla-reaches-deal-to-keep-5-n.y.-stores [https://perma.cc/YY9V-62BD] (reporting that Tesla and
sought a legislative carve-out to the state’s blanket prohibition on direct sales from manufacturers to consumers for high-end electric vehicles only. Eventually, to enhance the likelihood of legislative approval, Tesla sought to completely eliminate the prohibition altogether, allowing manufacturers to sell vehicles of any weight, class, size or shape directly to consumers. In its legislative proposals, Tesla faced fierce opposition in the state from the Texas Automobile Dealers Association which argued that the state’s prohibition prevents monopolies and promotes competition in vehicle pricing and service to the consumer. The Texas Automobile Dealers Association also cited state tax and employment benefits for the current law. As a workaround during these legislative battles, Tesla opened various service centers or “galleries” throughout the state where customers could speak to Tesla employees, view the online catalogue, ask any questions, and learn more about Tesla vehicles without the ability to actually purchase the vehicle from the gallery. Each customer was then directed to go online to purchase her vehicle and, when the vehicle was delivered to the Texas customer, it would arrive with California registration.

B. Public Policy, State Reactions, and Legislative Proposals

The public policy behind the above laws is to prevent manufacturers from competing with their own dealers—otherwise, manufacturers would take advantage of the information asymmetry and create more productive sales locations for themselves. As Tesla’s business model allows for manufacturer car sales only, there is no likelihood of dealer harm as anticipated when other manufacturers self-sell their own vehicles.

New York auto dealer lobbying groups reached an agreement to allow Tesla to keep its five company-owned stores in the state).


404. Id.

405. See Jeff Mosier, Why Texas’ $2,500 Electric Car Incentive Won’t Apply If You Buy a Tesla, DALLAS MORNING NEWS (June 11, 2018), https://www.dallasnews.com/business/autos/2018/06/11/texas-2500-electric-car-incentive-wont-apply-popular-brand [https://perma.cc/JG82-B6NZ] (explaining that Tesla is not eligible for a $2,500 new alternative-fuel incentive because its cars are not actually sold in the state).

406. Id.

407. Id.

408. Id.

409. Empie, supra note 395, at 851.

410. Id. at 851; see generally Barmore, supra note 390.
Application of these laws to Tesla is misplaced, but also raises bigger concerns. When state law does not allow Tesla to establish a manufacturer-owned store within a state, the state legislatures are indirectly attempting to influence and force Tesla to adopt a manufacturer-dealer-consumer model for its business.\textsuperscript{411} This approach creates a state influence over corporate operations and the free flow of commerce that scholars and opponents have begun to criticize as anti-consumer and anti-competitive.\textsuperscript{412} There are concerns that state politicians are attempting to control the marketplace and prevent interstate commerce.\textsuperscript{413}

How has this opposition impacted the legislative landscape? Thus far, the greatest efforts Tesla and its supporters have taken are geared towards lobbying state legislatures. The lobbyists have achieved mixed results throughout the states, with some legislatures even allowing existing Tesla stores to remain in operation as long as Tesla does not expand the number of business locations it has in the state.\textsuperscript{414} This minor victory will not assist Tesla in expanding the corporation in the future but will allow Tesla to keep its shop doors open in the near term until further reform can be accomplished.

As a greater victory, Tesla successfully fought New Jersey legal reform aimed at shutting down Tesla company stores in the state.\textsuperscript{415} The New Jersey Motor Vehicle Commission amended state law such that any party seeking a dealership license in the state was required to “produce evidence that the applicant or licensee is a franchisee” in order to obtain a license—something that Tesla would not be able to produce.\textsuperscript{416} In response, the New Jersey State Assembly’s Consumer Affairs Committee sponsored and unanimously enacted a new bill that reversed the Motor Vehicle Commission’s decision

\textsuperscript{411} Empie, supra note 395, at 851; see also Macy Cotton, Electric Avenue: How Texas Should Reform the Way Cars Are Sold and Allow Tesla to Sell Directly to Consumers, 16 TEX. TECH. ADMIN. L.J. 419, 439-440 (2015) (discussing the uphill battle that Tesla has faced against the Texas Automobile Dealers Association).

\textsuperscript{412} Empie, supra note 395, at 853.

\textsuperscript{413} Id.

\textsuperscript{414} Pennsylvania, Ohio, and New York have created such exemptions for existing Tesla locations. See Schwartz, supra note 402, at 594.

\textsuperscript{415} See Brian Fung, Tesla Won a Huge Victory in New Jersey, WASH. POST (Mar. 18, 2015), https://www.washingtonpost.com/news/the-switch/wp/2015/03/18/tesla-just-won-a-huge-victory-in-new-jersey/?noredirect=on&utm_term=.9e71163dd5e8 (reporting that Tesla can sell vehicles from company-owned dealerships in New Jersey after Governor Chris Christie signed a bill that allows for up to four locations).

and allowed Tesla to sell vehicles directly to consumers in New Jersey. It did so by specifically protecting “motor vehicle franchisor[s] licensed . . . on or prior to January 1, 2014 and exclusively manufacturing zero emission vehicles.”

Tesla has faced similar battles in other states. Recently, Connecticut’s Department of Motor Vehicles ruled that Tesla was selling cars out of its Greenwich “gallery” without a new car dealer’s license in violation of state law. The company immediately appealed the ruling citing that the ruling was an “unfortunate circumstance for Connecticut consumers.” According to the company, the State of Connecticut loses $5 million in tax revenue per year from consumers who simply go to New York to buy Tesla automobiles. This pro-consumer and pro-state argument was successful for the company in New York, Massachusetts, and Rhode Island which recently approved Tesla’s direct to consumer marketing system.

Similarly, in Utah, the company sought to operate in the state under the state’s current dealership law and built a $3 million store in Salt Lake City in 2015, but the full-fledged store was demoted to a gallery 2 weeks before opening due to the Utah Attorney General’s office ruling that the gallery was against the state’s direct consumer sales law. Since the ruling, the company obtained a used car dealer license and has sued the state for the right to sell in Utah. The company, however, lost its direct sales lawsuit in

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417. Id.
418. Id.
420. Id. For the fourth year in a row, a bill allowing Tesla to bring its direct-to-consumer business model to Connecticut cleared a General Assembly committee only to be stalled at the legislative level because Tesla has been unable to reach some middle ground with dealers, who have insisted the company abide by existing franchise rules that require sales through dealerships. See also Benjamin Kail, Tesla, Dealers Remain at Odds as Lawmakers Urge Compromise, DAY PUB. CO. (Mar. 25, 2018) https://www.theday.com/article/20180324/NWS12/180329607 [https://perma.cc/VVW6-SXQA] (discussing the necessity for car dealers and Tesla to find middle group in order to pass legislation on car sales).
421. Hladsky, supra note 419.
422. Id.
423. See Fred Lambert, Tesla Takes a Win for Direct Sales in Utah, Bill to Allow Operating Its Own Stores Goes to the Governor, ELECTREK (Mar. 9, 2018), https://electrek.co/2018/03/09/tesla-direct-sales-win-utah-bill/ [https://perma.cc/7HS8-45VP] (reporting on the status of H.B. 369, which would allow Tesla to sell its cars directly to consumers in Utah).
the Utah Supreme Court in 2017. After going through the court system, the company tried again to get approval for direct sales through the Utah legislature, which recently approved a bill to allow Tesla to conduct direct sales to consumers in the state.

The Federal Trade Commission ("FTC") expressed its disdain for the "no direct sales" laws on its blog, stating: "states should allow consumers to choose not only the cars they buy, but also how they buy them." The FTC took this position to allow Tesla to directly sell its vehicles to consumers, but also for any company that chooses to use this business model to distribute products. The FTC described how the marketplace itself is able to police inefficient or unsupported distribution practices, such that the government should not intervene unless extreme circumstances warrant intervention.

Currently, the embattled Tesla and its business model are slowly but surely winding their way through both courts and legislatures. Although the legal battles and legislative proposals are not yet settled, the company seems to be injecting a new perspective as to how cars can be sold in the United States as lawmakers begin to recognize that the advent of the Internet has made the old, dealer-only system of car sales antiquated. To have long-term success, Tesla will need to continue its legal efforts and also rectify its recent and very public issues on a company level as it seeks to control its Twitter-happy, brash, and temperamental CEO, Elon Musk, withstand SEC fraud investigations, decide whether or not to stay public, and maintain investor confidence as it blows production deadline after production deadline for its much-anticipated and affordable Model 3. Nevertheless, Tesla’s business model and the legal reform it seeks may be just what the Big Three need for success in the long run.

424. See Tesla Motors UT, Inc. v. Utah Tax Commission, 398 P.3d 55 (Utah 2017) (holding that the Franchise Act’s bar on the franchisor owner interest in a new motor vehicle dealer did not violate the applicant’s equal protection rights).
425. Lambert, supra note 423.
427. Id.
428. Id.
429. Id.
V. THE SUSTAINABILITY OF AUTO DEALERSHIPS: BAILOUTS, DIRECT SALES, AND “MIDDLEMEN”

With innovative technologies and methodologies similar to Tesla coming onto the scene, one cannot help but wonder what the future holds for the U.S. auto industry and, in particular, the Big Three. Those involved in the industry and the public alike have begun to question whether the system itself can continue to function as it is and, if it does, whether dealers will continue to play their role. The manufacturer-dealer relationship has a longstanding history of rarely being seriously questioned in the United States, as all players involved have always accepted it as a way of life. Now, Tesla has introduced a simpler sales process, which appeals to both automobile manufacturers and consumers alike (assuming that manufacturers can restructure to account for all costs related to taking on their own distribution). This simpler sales process has also eliminated the saturated, costly, labor-heavy, and overly expanded dealer networks that heavily bogged down the Big Three before and during the Financial Crisis and continues to do so now.

If the outcome of the Financial Crisis is any indication of things to come, the U.S. auto industry has been functioning in a financially volatile and risky way for too long. The bailout the Big Three received did not change this fact, as most, if not all, automobile dealerships are still highly leveraged against the vehicles they are selling to consumers. As an even more pressing concern, the reasons for why a bailout was necessary in the first place, such as overly-expanded dealer networks, legacy costs, and less desirable products, are still present in the U.S. auto industry. The American cars being produced today are not more valuable or appealing as a product to American consumers than they were before the bailout—the ultimate reason why a bailout was required in the first place.  

If anything, the public’s perception of American manufacturers has been further diminished by the safety scandals and failures of General Motors in recent years. Without increased support from the American public, the U.S. auto industry will ultimately fail, need an additional bailout, be forced to adopt new business models and practices, or some combination of all three options.

Thus, it appears that two main subjects will be at the forefront of the

431. See David Kiley, As Obama Takes Victory Lap Over Auto Industry Rescue, Here Are The Lessons Of The Bailout, FORBES (Jan. 20, 2016), https://www.forbes.com/sites/davidkiley/2016/01/20/obamas-takes-victory-lap-over-auto-industry-rescue/#355b73a03e83 (reporting that the bailouts of GM and Chrysler have done little to change the fundamental dynamics of the automobile industry that have caused it grief for decades).

432. Id.; see supra notes 334-342 and accompanying text.
U.S. auto industry in the upcoming years: (1) whether the bailout was, indeed, a temporary fix of manufacturer problems and (2) whether the direct-sales model and challenges brought by Tesla and similar companies will be a much more sustainable business model for the U.S. auto industry in the long run.\(^{433}\)

From the franchisor manufacturer’s perspective, the majority of franchise laws enacted in the United States over the past decades have become more and more dealer-friendly; for example, the Day in Court Act and state laws prohibiting non-franchisees from dealing in vehicles are oriented towards the interests of dealers.\(^{434}\) In fact, the Alliance of Automobile Manufacturers has begun to recognize this shift in power and the need to maintain open-mindedness about how “best to serve new-car buyers in the future.”\(^{435}\) This need to be open-minded is perhaps influenced by the feeling that the original justifications for creating and maintaining a manufacturer-dealer-consumer model no longer apply. As Philip Delves Broughton of The New Yorker describes this transition, “[c]onsumers can go online and find the specs of any car they might want. They can apply for credit online. They can sell their old cars on eBay or Craigslist. They can get cheaper parts and service at a local mechanic . . . [t]he dealer has become superfluous.”\(^{436}\) For the manufacturer, this means that a dealership is no longer the only viable resource for reaching consumers and performing the tasks that dealerships were traditionally needed to perform.

From the perspective of the consumer, a direct sale from the manufacturer can be quicker and more cost effective than purchasing a vehicle from a dealership—most American consumers would likely agree

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433. Lao, Feinstein & Lafontaine, supra note 426. Another company that uses the direct-sales model is Elio Motors, which had 41,000 reservations for vehicles to be bought directly from their manufacturing facilities in March 2015. Id. (In expressing its dislike of state restrictions that prohibit companies like Tesla from directly selling to consumers, the FTC said, “[a] fundamental principle of competition is that consumers – not regulation – should determine what they buy and how they buy it. Consumers may benefit from the ability to buy cars directly from manufacturers – whether they are shopping for luxury cars or economy vehicles. The same competition principles should apply in either case.”) Id.


435. Id.

with this sentiment based off of the public’s perception of the “car salesman.” The dealership franchising business has been characterized as having a “middleman effect” on the sales process, where the dealer’s presence increases the prices of the products sold. Studies indicate that the dealer system adds 5 percent to 10 percent to the cost of each vehicle produced.

This “middleman effect” does not only yield negative results for the consumer, however. As middlemen, dealers operate as liaisons for the consumer to the manufacturer. In a technology-driven and evolving society, it is important for consumers to get the most for their money and have their concerns addressed promptly, especially with a crucial product as important and costly as a vehicle. Without dealers, it is difficult to envision how consumers will have all of their needs met, especially without the “personal factor” that dealers bring to the local communities where they operate and often have a longstanding and intimate familiarity; these dealers’ markets have the economic or social circumstances, demographics, and key business people and other leaders that dealers typically have worked and lived around, as well as learned from, usually for many years, if not a lifetime.

CONCLUSION

In sum, dealers and their proponents claim that, as an entity, they are in place to protect the consumer. In contrast, consumers appreciate options and liberty in choosing what works best for them. Tesla’s business goal seems to project the same sentiment: “to accelerate the advent of sustainable transport by bringing compelling mass market electric cars to market as soon


439. See, e.g., Claudia Assis, Tesla Vows to Keep Selling Cars Directly to Missouri Customers, MARKETWATCH (Sept. 8, 2016), https://www.marketwatch.com/story/tesla-vows-to-keep-selling-cars-directly-to-missouri-customers-2016-09-08/ [https://perma.cc/S4CK-B7LG] (describing dealer argument that dealers protect consumers); Auto Dealers Chief Wars of Tesla Direct Sales Model, supra note 393 (describing dealer argument that dealers lower the price of vehicles for consumers); State Franchise Laws, Sparked by Tesla, supra note 434 (explaining how dealer-backed legislation is shifting the dealer-automaker relationship too far in favor of dealers).
as possible.” Tesla’s direct sales model achieves this goal while also eliminating the franchise-dealer/middlemen costs that are passed along to the consumer in the traditional franchise-dealer system. Indeed, if the Big Three intend to avoid another bailout, adjust to the Internet age, and remain viable and competitive as companies domestically and against their much more efficient international competition in the long run, the franchisee-dealer system, and its associated costs, may need to become a thing of the past—or, inevitably, the U.S. auto industry, itself, may become a thing of the past.